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Statement on Standards for Attestation Engagements

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Amendments to Statement on Standards for Attestation Engagements Nos. 1, 2, and 3

(Amends Statement on Standards for Attestation Engagements No. 1, AICPA, Professional Standards, vol. 1, AT sec. 100; Statement on Standards for Attestation Engagements No. 2, AICPA, Professional Standards, vol. 1, AT sec. 400; and Statement on Standards for Attestation Engagements No. 3, AICPA, Professional Standards, vol. 1, AT sec. 500.)

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Attestation Standards

General Standards*

1. The engagement shall be performed by a practitioner or practitioners having adequate technical training and proficiency in the attest function.
2. The engagement shall be performed by a practitioner or practitioners having adequate knowledge in the subject matter of the assertion.
3. The practitioner shall perform an engagement only if he or she has reason to believe that the following two conditions exist.
 - The assertion is capable of evaluation against reasonable criteria that either have been established by a recognized body or are stated in the ~~presentation of the~~ assertion in a sufficiently clear and comprehensive manner for a knowledgeable reader to be able to understand them.
 - The assertion is capable of reasonably consistent estimation or measurement using such criteria.
4. In all matters relating to the engagement, an independence in mental attitude shall be maintained by the practitioner or practitioners.
5. Due professional care shall be exercised in the performance of the engagement.

Standards of Fieldwork

1. The work shall be adequately planned and assistants, if any, shall be properly supervised.
2. Sufficient evidence shall be obtained to provide a reasonable basis for the conclusion that is expressed in the report.

Standards of Reporting

1. The report shall identify the assertion being reported on and state the character of the engagement.

* Throughout, new language is shown in boldface italics; deleted language is shown by strikethrough.

2. The report shall state the practitioner's conclusion about whether the **reliability of the** assertion ~~is presented in conformity with~~ **based on** the established or stated criteria against which it was measured.
 3. The report shall state all of the practitioner's significant reservations about the engagement and the ~~presentation of the~~ assertion.
 4. The report on an engagement to evaluate an assertion that has been prepared **based on** ~~in conformity with~~ agreed-upon criteria or on an engagement to apply agreed-upon procedures should contain a statement limiting its use to the parties who have agreed upon such criteria or procedures.
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Amendment to Statement on Standards for Attestation Engagements No. 1, *Attestation Standards*

(Amends *Statement on Standards for Attestation Engagements No. 1*, AICPA, Professional Standards, vol. 1, AT sec. 100)

RECENT

Attest Engagement

1. When a certified public accountant in the practice of public accounting (herein referred to as a “practitioner”) performs an attest engagement, as defined below, the engagement is subject to the attestation standards and related interpretive commentary in this pronouncement and to any other authoritative interpretive standards that apply to the particular engagement.^{1, 2}

An attest engagement is one in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion³ that is the responsibility of another party.⁴

1. “A certified public accountant in the practice of public accounting” includes any of the following who perform or assist in the attest engagement: (1) an individual public accountant; (2) a proprietor, partner, or shareholder in a public accounting firm; (3) a full- or part-time employee of a public accounting firm; and (4) an entity (for example, partnership, corporation, trust, joint venture, or pool) whose operating, financial, or accounting policies can be significantly influenced by one of the persons described in (1) through (3) or by two or more of such persons if they choose to act together.

2. Existing authoritative standards that might apply to a particular attest engagement include *Statements on Auditing Standards*, ~~and Statements on Standards for Accounting and Review Services, and Statement on Standards for Accountants’ Services on Prospective Financial Information~~. In addition, authoritative interpretive standards for specific types of attest engagements, including standards concerning the subject matter of the assertions presented, may be issued in the future by authorized AICPA senior technical committees. Furthermore, when a practitioner undertakes an attest engagement for the benefit of a government body or agency and agrees to follow specified government standards, guides, procedures, statutes, rules, and regulations, the practitioner is obliged to follow this Statement and the applicable authoritative interpretive standards, as well as those governmental requirements.

3. An assertion is any declaration, or set of related declarations taken as a whole, by a party responsible for it. **A conclusion on the reliability of a written assertion may refer to that assertion, except as discussed in paragraph 51, or to the subject matter to which the assertion relates (see paragraphs 47 through 69).**

4. The term *attest* and its variants, such as *attesting* and *attestation*, are used in a number of state accountancy laws, and in regulations issued by State Boards of Accountancy under such laws, for different purposes and with different meanings from those intended by this Statement. Consequently, the definition of *attest engagement* set out in this paragraph, and the attendant meaning of *attest* and *attestation* as used throughout the Statement should not be understood as defining these terms, and similar terms, as they are used in any law or regulation, nor as embodying a common understanding of the terms which may also be reflected in such laws or regulations.

2. Examples of professional services typically provided by practitioners that would not be considered attest engagements include—

- a.* Management consulting engagements in which the practitioner is engaged to provide advice or recommendations to a client.
- b.* Engagements in which the practitioner is engaged to advocate a client's position—for example, tax matters being reviewed by the Internal Revenue Service.
- c.* Tax engagements in which a practitioner is engaged to prepare tax returns or provide tax advice.
- d.* Engagements in which the practitioner compiles financial statements, because he or she is not required to examine or review any evidence supporting the information furnished by the client and does not express any conclusion on its reliability.
- e.* Engagements in which the practitioner's role is solely to assist the client—for example, acting as the company accountant in preparing information other than financial statements.
- f.* Engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts.
- g.* Engagements in which a practitioner is engaged to provide an expert opinion on certain points of principle, such as the application of tax laws or accounting standards, given specific facts provided by another party so long as the expert opinion does not express a conclusion about the reliability of the facts provided by another party.

3. The practitioner who does not explicitly express a conclusion about the reliability of an assertion that is the responsibility of another party should be aware that there may be circumstances in which such a conclusion could be reasonably inferred. For example, if the practitioner issues a report that includes an enumeration of procedures that could reasonably be expected to provide assurance about an assertion, the practitioner may not be able to avoid the inference that the report is an attest report merely by omitting an explicit conclusion on an assertion.

4. The practitioner who has assembled or assisted in assembling an assertion should not claim to be the asserter if the assertion is materially dependent on the actions, plans, or assumptions of some other individual or group. In such a situation, that other individual or group

is the “asserter,” and the practitioner will be viewed as an attester if a conclusion about the reliability of the assertion is expressed.

5. An attest engagement may be part of a larger engagement—for example, a feasibility study or business acquisition study that includes an examination of prospective financial information. In such circumstances, these standards apply only to the attest portion of the engagement.

The Relationship of Attestation Standards to Quality Control Standards

6. The independent practitioner is responsible for compliance with the AICPA's Statements on Standards for Attestation Engagements (SSAEs) in an attest engagement. Rule 202, “Compliance with Standards,” of the Code of Professional Conduct (AICPA, Professional Standards, vol. 2, ET sec. 202), requires members to comply with such standards when conducting professional services.

7. A firm of independent practitioners also needs to comply with the quality control standards⁵ in the conduct of a firm's attest practice. Thus, a firm should establish quality control policies and procedures to provide it with reasonable assurance of conforming with attestation standards in its attest engagements. The nature and extent of a firm's quality control policies and procedures depend on factors such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

8. Attestation standards relate to the conduct of individual attest engagements; quality control standards relate to the conduct of a firm's attest practice as a whole. Thus, attestation standards and quality control standards are related and the quality control policies and procedures that a firm adopts may affect both the conduct of individual attest engagements and the conduct of a firm's attest practice as a whole.

5. The elements of quality control are identified in Statement on Quality Control Standards (SQCS) No. 2, System of Quality Control for a CPA Firm's Accounting and Auditing Practice (AICPA, Professional Standards, vol. 2, QC sec. 20).

General Standards

9. The first general standard is—*The engagement shall be performed by a practitioner or practitioners having adequate technical training and proficiency in the attest function.*

10. Performing attest services is different from preparing and presenting an assertion. The latter involves collecting, classifying, summarizing, and communicating information; this usually entails reducing a mass of detailed data to a manageable and understandable form. On the other hand, performing attest services involves gathering evidence to support the assertion and objectively assessing the measurements and communications of the asserter. Thus, attest services are analytical, critical, investigative, and concerned with the basis and support for the assertions.

11. The attainment of proficiency as an attester begins with formal education and extends into subsequent experience. To meet the requirements of a professional, the attester's training should be adequate in technical scope and should include a commensurate measure of general education.

12. The second general standard is—*The engagement shall be performed by a practitioner or practitioners having adequate knowledge in the subject matter of the assertion.*

13. A practitioner may obtain adequate knowledge of the subject matter to be reported on through formal or continuing education, including self-study, or through practical experience. However, this standard does not necessarily require a practitioner to personally acquire all of the necessary knowledge in the subject matter to be qualified to judge an assertion's reliability **to express a conclusion about the reliability of an assertion.** This knowledge requirement may be met, in part, through the use of one or more specialists on a particular attest engagement if the practitioner has sufficient knowledge of the subject matter (a) to communicate to the specialist the objectives of the work and (b) to evaluate the specialist's work to determine if the objectives were achieved.

14. The third general standard is—*The practitioner shall perform an engagement only if he or she has reason to believe that the following two conditions exist:*

- a. *The assertion is capable of evaluation against reasonable criteria that either have been established by a recognized body or are stated in the ~~presentation of the~~ assertion in a sufficiently clear and comprehensive manner for a knowledgeable reader to be able to understand them.*
- b. *The assertion is capable of reasonably consistent estimation or measurement using such criteria.*

15. The attest function should be performed only when it can be effective and useful. Practitioners should have a reasonable basis for believing that a meaningful conclusion can be provided on an assertion.

16. The first condition requires an assertion to have reasonable criteria against which it can be evaluated. Criteria promulgated by a body designated by Council under the AICPA *Code of Professional Conduct* are, by definition, considered to be reasonable criteria for this purpose. Criteria issued by regulatory agencies and other bodies composed of experts that follow due-process procedures, including procedures for broad distribution of proposed criteria for public comment, normally should also be considered reasonable criteria for this purpose.

17. However, criteria established by industry associations or similar groups that do not follow due process or do not as clearly represent the public interest should be viewed more critically. Although established and recognized in some respects, such criteria should be considered similar to measurement and disclosure criteria that lack authoritative support, and the practitioner should evaluate whether they are reasonable. Such criteria should be stated in ~~the presentation of~~ the assertion in a sufficiently clear and comprehensive manner for knowledgeable readers to be able to understand them.

18. Reasonable criteria are those that yield useful information. The usefulness of information depends on an appropriate balance between relevance and reliability. Consequently, in assessing the reasonableness of measurement and disclosure criteria, the practitioner should consider whether the assertions generated by such criteria **has** ~~have~~ an appropriate balance of the following characteristics:

- a. Relevance
 - *Capacity to make a difference in a decision*—The assertions ~~are~~ **is** useful in forming predictions about the outcomes of past,

present, and future events or in confirming or correcting prior expectations.

- *Ability to bear upon uncertainty*—The assertions ~~are~~ **is** useful in confirming or altering the degree of uncertainty about the result of a decision.
- *Timeliness*—The assertions ~~are~~ **is** available to decision makers before ~~they it~~ loses ~~their its~~ capability to influence decisions.
- *Completeness*—The assertions ~~do~~ **does** not omit information that could alter or confirm a decision.
- *Consistency*—The assertions ~~are~~ **is** measured and presented in materially the same manner in succeeding time periods or (if material inconsistencies exist) changes are disclosed, justified, and, where practical, reconciled to permit proper interpretations of sequential measurements.

b. Reliability

- *Representational faithfulness*—The assertions ~~corresponds~~ **corresponds** or agrees with the phenomena ~~they it~~ purports to represent.
- *Absence of unwarranted inference of certainty or precision*—The assertions ~~may~~ sometimes be presented more appropriately through the use of ranges or indications of the probabilities attaching to different values rather than as **single point estimates**.
- *Neutrality*—The primary concern is the relevance and reliability of the assertions rather than ~~their its~~ potential effect on a particular interest.
- *Freedom from bias*—The measurements involved in the assertions are equally likely to fall on either side of what they represent rather than more often on one side than the other.

19. Some criteria are reasonable in evaluating ~~a presentation of assertions~~ **an assertion** for only a limited number of specified users who participated in their ~~development establishment~~ **(specified criteria)**. For instance, criteria set forth in a purchase agreement for the preparation and presentation of financial statements of a company to be acquired, when materially different from generally accepted accounting principles (GAAP), are reasonable only when reporting to the parties to the agreement.

20. Even when reasonable criteria exist, the practitioner should consider whether the assertion is also capable of reasonably consistent estimation or measurement using those criteria.⁶ Competent persons using the same or similar measurement and disclosure criteria ordinarily should be able to obtain materially similar estimates or measurements. However, competent persons will not always reach the same conclusion because (a) such estimates and measurements often require the exercise of considerable professional judgment and (b) a slightly different evaluation of the facts could yield a significant difference in the presentation of a particular assertion. An assertion estimated or measured using criteria promulgated by a body designated by Council under the AICPA *Code of Professional Conduct* is considered, by definition, to be capable of reasonably consistent estimation or measurement.

21. A practitioner should not provide assurance on an assertion that is so subjective (for example, the “best” software product from among a large number of similar products) that people having competence in and using the same or similar measurement and disclosure criteria would not ordinarily be able to obtain materially similar estimates or measurements. A practitioner’s assurance on such an assertion would add no real credibility to the assertion; consequently, it would be meaningless at best and could be misleading.

22. The second condition does not presume that all competent persons would be expected to select the same measurement and disclosure criteria in developing a particular estimate or measurement (for example, the provision for depreciation on plant and equipment). However, assuming the same measurement and disclosure criteria were used (for example, the straight-line method of depreciation), materially similar estimates or measurements would be expected to be obtained.

23. Furthermore, for the purpose of assessing whether particular measurement and disclosure criteria can be expected to yield reasonably consistent estimates or measurements, materiality must be judged in light of the expected range of reasonableness for a particular assertion. For instance, “soft” information, such as forecasts or projections, would be expected to have a wider range of reasonable estimates than “hard” data, such as the quantity of inventory existing at a specific location.

6. Criteria may yield quantitative or qualitative estimates or measurement.

24. The second condition applies equally whether the practitioner has been engaged to perform an *examination* or a *review* of ~~a presentation of assertions~~ **an assertion** (see the second reporting standard). Consequently, it is inappropriate to perform a review engagement where the practitioner concludes that an examination cannot be performed because competent persons using the same or similar measurement and disclosure criteria would not ordinarily be able to obtain materially similar estimates or measurements. For example, practitioners should not provide limited assurance on the assertion that a particular software product is the “best” among a large number of similar products because they could not provide the highest level of assurance (a positive opinion) on such an assertion (were they engaged to do so) because of its inherent subjectivity.

25. The fourth general standard is—*In all matters relating to the engagement, an independence in mental attitude shall be maintained by the practitioner or practitioners.*

26. The practitioner should maintain the intellectual honesty and impartiality necessary to reach an unbiased conclusion about the assertion. This is a cornerstone of the attest function. Consequently, practitioners performing an attest service should not only be independent in fact, but also should avoid situations that may impair the appearance of independence.

27. In the final analysis, independence means objective consideration of facts, unbiased judgments, and honest neutrality on the part of the practitioner in forming and expressing conclusions. It implies not the attitude of a prosecutor but a judicial impartiality that recognizes an obligation for fairness. Independence presumes an undeviating concern for an unbiased conclusion about the reliability of an assertion no matter what the assertion may be.

28. The fifth general standard is—*Due professional care shall be exercised in the planning and performance of the engagement.*

29. Due care imposes a responsibility on each practitioner involved with the engagement to observe each of the attestation standards. Exercise of due care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including the preparation of the report.

30. *Cooley on Torts*, a treatise that has stood the test of time, describes a professional’s obligation for due care as follows:

Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon mere errors of judgment.⁷

Standards of Fieldwork

31. The first standard of fieldwork is—*The work shall be adequately planned and assistants, if any, shall be properly supervised.*

32. Proper planning and supervision contribute to the effectiveness of attest procedures. Proper planning directly influences the selection of appropriate procedures and the timeliness of their application, and proper supervision helps ensure that planned procedures are appropriately applied.

33. Planning an attest engagement involves developing an overall strategy for the expected conduct and scope of the engagement. To develop such a strategy, practitioners need to have sufficient knowledge to enable them to understand adequately the events, transactions, and practices that, in their judgment, have a significant effect on the presentation of the assertions.

34. Factors to be considered by the practitioner in planning an attest engagement include the following:

- a. The presentation criteria to be used
- b. The anticipated level of attestation risk⁸ related to the assertions on which he or she will report

7. D. Haggard, *Cooley on Torts*, 472 (4th ed., 1932).

8. *Attestation risk* is the risk that the practitioner may unknowingly fail to appropriately modify his or her attest report on an assertion that is materially misstated. It consists of (a) the risk (consisting of inherent risk and control risk) that the assertion contains errors that could be material and (b) the risk that the practitioner will not detect such errors (detection risk).

- c. Preliminary judgments about materiality levels for attest purposes
- d. The items within the assertion that are likely to require revision or adjustment
- e. Conditions that may require extension or modification of attest procedures
- f. The nature of the report expected to be issued

35. The practitioner should establish an understanding with the client regarding the services to be performed for each engagement.⁹ Such an understanding reduces the risk that either the practitioner or the client may misinterpret the needs or expectations of the other party. For example, it reduces the risk that the client may inappropriately rely on the practitioner to protect the entity against certain risks or to perform certain functions that are the client's responsibility. The understanding should include the objectives of the engagement, management's responsibilities, the practitioner's responsibilities, and limitations of the engagement. The practitioner should document the understanding in the working papers, preferably through a written communication with the client. If the practitioner believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

36. The nature, extent, and timing of planning will vary with the nature and complexity of the assertions and the practitioner's prior experience with management. As part of the planning process, the practitioner should consider the nature, extent, and timing of the work to be performed to accomplish the objectives of the attest engagement. Nevertheless, as the attest engagement progresses, changed conditions may make it necessary to modify planned procedures.

37. Supervision involves directing the efforts of assistants who participate in accomplishing the objectives of the attest engagement and determining whether those objectives were accomplished. Elements of supervision include instructing assistants, staying informed of significant problems encountered, reviewing the work performed, and dealing with differences of opinion among personnel. The extent of supervision appropriate in a given instance depends on many factors, including the nature and complexity of the subject matter and the qualifications of the persons performing the work.

9. See Statement on Quality Control Standards No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, paragraph 16 [QC section 20.16].

38. Assistants should be informed of their responsibilities, including the objectives of the procedures that they are to perform and matters that may affect the nature, extent, and timing of such procedures. The practitioner with final responsibility for the engagement should direct assistants to bring to his or her attention significant questions raised during the attest engagement so that their significance may be assessed.

39. The work performed by each assistant should be reviewed to determine if it was adequately performed and to evaluate whether the results are consistent with the conclusion to be presented in the practitioner's report.

40. The second standard of fieldwork is—*Sufficient evidence shall be obtained to provide a reasonable basis for the conclusion that is expressed in the report.*

41. Selecting and applying procedures that will accumulate evidence that is sufficient in the circumstances to provide a reasonable basis for the level of assurance to be expressed in the attest report requires the careful exercise of professional judgment. A broad array of available procedures may be applied in an attest engagement. In establishing a proper combination of procedures to appropriately restrict attestation risk, the practitioner should consider the following presumptions, bearing in mind that they are not mutually exclusive and may be subject to important exceptions.

- a. Evidence obtained from independent sources outside an entity provides greater assurance of an assertion's reliability than evidence secured solely from within the entity.
- b. Information obtained from the independent attester's direct personal knowledge (such as through physical examination, observation, computation, operating tests, or inspection) is more persuasive than information obtained indirectly.
- c. The more effective the internal control the more assurance it provides about the reliability of the assertions.

42. Thus, in the hierarchy of available attest procedures, those that involve search and verification (for example, inspection, confirmation, or observation), particularly when using independent sources outside the entity, are generally more effective in reducing attestation risk than those involving internal inquiries and comparisons of internal information (for example, analytical procedures and discussions

with individuals responsible for the assertion). On the other hand, the latter are generally less costly to apply.

43. In an attest engagement designed to provide the highest level of assurance on an assertion (an *examination*), the practitioner's objective is to accumulate sufficient evidence to limit attestation risk to a level that is, in the practitioner's professional judgment, appropriately low for the high level of assurance that may be imparted by his or her report. In such an engagement, a practitioner should select from all available procedures—that is, procedures that assess inherent and control risk and restrict detection risk—any combination that can limit attestation risk to such an appropriately low level.

44. In a limited assurance engagement (a *review*), the objective is to accumulate sufficient evidence to limit attestation risk to a moderate level. To accomplish this, the types of procedures performed generally are limited to inquiries and analytical procedures (rather than also including search and verification procedures).

45. Nevertheless, there will be circumstances when inquiry and analytical procedures (a) cannot be performed, (b) are deemed less efficient than other procedures, or (c) yield evidence indicating that the assertion may be incomplete or inaccurate. In the first circumstance, the practitioner should perform other procedures that he or she believes can provide him or her with a level of assurance equivalent to that which inquiries and analytical procedures would have provided. In the second circumstance, the practitioner may perform other procedures that he or she believes would be more efficient to provide him or her with a level of assurance equivalent to that which inquiries and analytical procedures would provide. In the third circumstance, the practitioner should perform additional procedures.

46. The extent to which attestation procedures will be performed should be based on the level of assurance to be provided and the practitioner's consideration of (a) the nature and materiality of the information **to be tested** to the ~~presentation of the~~ assertions taken as a whole, (b) the likelihood of misstatements, (c) knowledge obtained during current and previous engagements, (d) the assenter's competence in the subject matter of the assertion, (e) the extent to which the information is affected by the assenter's judgment, and (f) inadequacies in the assenter's underlying data.

Standards of Reporting

47. The first standard of reporting is—*The report shall identify the assertion being reported on and state the character of the engagement.*

48. The practitioner who accepts an attest engagement should issue a report on the assertions **or the subject matter to which the assertion relates** or withdraw from the attest engagement. ~~When a written report is issued, the assertion should be identified by referring to a separate presentation of assertions that is the responsibility of the asserter. The presentation of assertions should generally be bound with or accompany the practitioner's report. Because the asserter's responsibility for the assertions should be clear, it is ordinarily not sufficient merely to include the assertions in the practitioner's report. Management's assertion should be bound with or accompany the practitioner's report or the assertion should be clearly stated in the practitioner's report.~~

49. The statement of the character of an attest engagement that is designed to result in a general-distribution report includes two elements: (a) a description of the nature and scope of the work performed and (b) a reference to the professional standards governing the engagement. When the form of the statement is prescribed in authoritative interpretive standards (for example, an **examination audit** in accordance with **generally accepted auditing standards [GAAS]**), that form should be used in the practitioner's report. However, when no such interpretive standards exist, (a) the terms *examination* and *review* should be used to describe engagements to provide, respectively, the highest level and a moderate level of assurance, and (b) the reference to professional standards should be accomplished by referring to "standards established by the American Institute of Certified Public Accountants."

50. The statement of the character of an attest engagement in which the practitioner applies agreed-upon procedures should refer to conformity with the arrangements made with the specified user(s). Such engagements are designed to accommodate the specific needs of the parties in interest and should be described by identifying the procedures agreed upon by such parties.

51. The second standard of reporting is—*The report shall state the practitioner's conclusion about **the reliability of the assertion based***

~~on whether the assertion is in conformity with the established or stated criteria against which it was measured. A conclusion on the reliability of a written assertion may refer to that assertion or to the subject matter to which the assertion relates. However, if conditions exist that, individually or in combination, result in one or more material deviations from the criteria, the practitioner should modify the report and, to most effectively communicate with the reader of the report, should ordinarily express his or her conclusion directly on the subject matter,¹⁰ not on management's assertion.~~

52. The practitioner should consider the concept of materiality in applying this standards. In expressing a conclusion on the ~~conformity of a presentation of assertions with established~~ **reliability of the assertion based on the** established or stated criteria ~~against which it was measured~~, the practitioner should consider ~~the an omission or a misstatement of an individual assertion~~ to be material if ~~the magnitude of the omission or misstatement—individually or when aggregated with others omissions or misstatements—is such that a reasonable person relying on the presentation of assertions would be influenced by the omission or misstatement inclusion or correction of the individual assertion.~~ The relative, rather than absolute, size of an omission or misstatement determines whether it is material in a given situation.

53. General-distribution attest reports should be limited to two levels of assurance: one based on a reduction of attestation risk to an appropriately low level (an *examination*) and the other based on a reduction of attestation risk to a moderate level (a *review*).

54. In an engagement to achieve the highest level of assurance (an *examination*), the practitioner's conclusion should be expressed in the form of ~~an positive~~ opinion. When attestation risk has been reduced only to a moderate level (a *review*), the conclusion should be expressed in the form of negative assurance.

Examination

55. When expressing ~~an positive~~ opinion, the practitioner should clearly state whether, in his or her opinion, ~~the presentation of (a)~~

10. *Specific standards may require that the practitioner express his or her conclusion directly on the subject matter.* For example, if management states in its assertion that a material weakness exists in the entity's internal control over financial reporting, the practitioner should state his or her opinion directly on the effectiveness of internal control, not on management's assertion related thereto.

management's assertions is presented *[or fairly stated]*, in all material respects, based on *[or in conformity with]* the established or stated criteria **or (b) the subject matter of the assertion is based on [or in conformity with] the established or stated criteria in all material respects.** Reports expressing an ~~positive~~ opinion on **the reliability of an presentation of assertions taken as a whole**, however, may be qualified or modified for some aspect of the ~~presentation~~ **assertion** or the engagement (see the third reporting standard). In addition, such reports may emphasize certain matters relating to the attest engagement or the ~~presentation of~~ assertions.

56. The practitioner's report on an examination should include the following:

- a. A title that includes the word independent**
- b. An identification of management's assertion (When management's assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of management's assertion.)**
- c. A statement that the assertion is the responsibility of management**
- d. A statement that the practitioner's responsibility is to express an opinion on management's assertion [or the subject matter of management's assertion] based on his or her examination**
- e. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and, accordingly, included procedures that the practitioner considered necessary in the circumstances**
- f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion**
- g. The practitioner's opinion on whether—**
 - (1) Management's assertion is presented [or fairly stated], in all material respects, based on [or in conformity with] the established or stated¹¹ criteria, or**
 - (2) The subject matter of the assertion is based on [or in conformity with] the established or stated criteria in all material respects.**

11. Stated criteria also include specified criteria as described in paragraph 19.

h. When the assertion has been prepared based on specified criteria that have been agreed upon by the asserter and the specified parties, the practitioner's report should also contain—

(1) A statement of limitations on the use of the report because it is intended solely for specified parties (see the fourth reporting standard)

(2) A statement, when established criteria exist, that the assertion is not intended to be that which would have been presented if the assertion were presented based on [identify established criteria]

i. The manual or printed signature of the practitioner's firm

j. The date of the examination report

57. The form of the practitioner's report will depend on the following:

a. Whether the practitioner opines on management's assertion or the subject matter of management's assertion

b. Whether management's assertion is presented separately and accompanies the practitioner's report or whether management's assertion is only stated in the practitioner's report

The report examples included in this Statement assume that management's assertion accompanies the practitioner's report. SSAE No. 2, Reporting on an Entity's Internal Control Over Financial Reporting (AICPA, Professional Standards, vol. 1, AT sec. 400), and SSAE No. 3, Compliance Attestation (AICPA, Professional Standards, vol. 1, AT sec. 500), provide report examples for when management's assertion accompanies the practitioner's report and when there is no accompanying assertion. They also provide examples of reports that express an opinion on management's assertion or on the subject matter of management's assertion.

58. The following is an illustration of an examination report that expresses an unqualified opinion on an presentation of assertions, assuming that no specific report form has been prescribed in authoritative interpretive standards.

Independent Accountant's Report

We have examined the accompanying [identify the presentation of the assertions—for example, *Statement of Investment Performance*

Statistics of XYZ Fund for the year ended December 31, 19XX1]. Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary in the circumstances. **This statement is the responsibility of the Fund's management. Our responsibility is to express an opinion on this statement based on our examination.**

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining on a test basis, evidence supporting the [identify the assertion—for example, Statement of Investment Performance Statistics] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the ~~presentation of the assertion~~.]

In our opinion, the [identify the ~~presentation of~~ assertions—for example, Statement of Investment Performance Statistics] referred to above presents [identify the **subject matter of the** assertion—for example, the investment performance of XYZ Fund for the year ended December 31, 19XX1], **in all material respects, based on its conformity with** [identify established or stated criteria—for example, the measurement and disclosure criteria set forth in Note 1].

[Signature]

[Date]

55. When the assertion has been prepared in conformity with specified criteria that have been agreed upon by the asserter and the user, the practitioner's report should also contain—

- a. **A statement of limitations on the use of the report because it is intended solely for specified parties (see the fourth reporting standard).**
- b. **An indication, when applicable, that the presentation of assertions differs materially from that which would have been presented if criteria for the presentation of such assertions for general distribution had been followed in its preparation (for example, financial statements prepared in accordance with criteria specified in a contractual arrangement may differ materially from statements prepared in conformity with GAAP).**

Review

59. In providing negative assurance, the practitioner's conclusion should state whether any information came to the practitioner's attention on the basis of the work performed that indicates that the assertions ~~are is~~ not presented in all material respects ***based on in*** ~~conformity with~~ established or stated criteria. (As discussed more fully in the commentary to the third reporting standard, if the assertions ~~are is~~ not modified to correct for any such information that comes to the practitioner's attention, such information should be described in the practitioner's report.)

~~57. A practitioner's negative assurance report may also comment on or emphasize certain matters relating to the attest engagement or the presentation of the assertions. Furthermore, the practitioner's report should—~~

- ~~a. Indicate that the work performed was less in scope than an examination.~~
- ~~b. Disclaim a positive opinion on the assertions.~~
- ~~c. Contain the additional statements noted in paragraph .55 when the presentation of the assertions has been prepared in conformity with specified criteria that have been agreed upon by the asserter and user(s).~~

60. The practitioner's report on a review should include the following:

- a. A title that includes the word independent***
- b. An identification of management's assertion (When management's assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of management's assertion.)***
- c. A statement that the assertion is the responsibility of management***
- d. A statement that the review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants***
- e. A statement that a review is substantially less in scope than an examination, the objective of which is an expression of opinion on the assertion (or subject matter of the assertion), and accordingly, no such opinion is expressed***

- f. A statement about whether the practitioner is aware of any material modifications that should be made to the assertion in order for it to be presented [or fairly stated], in all material respects, based on [or in conformity with] the established or stated¹² criteria, other than those modifications, if any, indicated in his or her report or a statement about whether the practitioner is aware of any material modifications that should be made to the subject matter of the assertion in order for it to be based on [or in conformity with], in all material respects, the established or stated¹³ criteria, other than those modifications, if any, indicated in his or her report*
- g. If the assertion has been prepared based on specified criteria that have been agreed upon by the asserter and the specified users, the practitioner's report should also contain—*
 - (1) A statement of limitations on the use of the report because it is intended solely for specified parties (see the fourth reporting standard)*
 - (2) A statement, when established criteria exist, that the assertion is not intended to be that which would have been presented if the assertion were presented based on [identify established criteria]*
- h. The manual or printed signature of the practitioner's firm*
- i. The date of the review report*

61. The following is an illustration of a review report that expresses negative assurance where no exceptions have been found, assuming that no specific report form is prescribed in authoritative interpretive standards:

Independent Accountant's Report

We have reviewed the accompanying [*identify the presentation of the assertions—for example, Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 19XX±*]. ***This statement is the responsibility of the Fund's management.*** ~~Our review was conducted in accordance with standards established by the American Institute of Certified Public Accountants.~~

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public

12. *Stated criteria also include specified criteria as described in paragraph 19.*

13. *Stated criteria also include specified criteria as described in paragraph 19.*

Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the ~~[identify the presentation of the assertions—for example, Statement of Investment Performance Statistics]~~. Accordingly, we do not express such an opinion.

[Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the ~~presentation of the assertion.~~]

Based on our review, nothing came to our attention that caused us to believe that the accompanying ~~[identify the presentation of assertions—for example, Statement of Investment Performance Statistics]~~ is not presented **in all material respects based on** ~~in conformity with [identify the established or stated criteria—for example, the measurement and disclosure criteria set forth in Note 1].~~

[Signature]

[Date]

Agreed-Upon-Procedures-

Other Reporting Requirements

62. The third standard of reporting is—*The report shall state all of the practitioner's significant reservations about the engagement and the ~~presentation of the assertions.~~*

63. “Reservations about the engagement” refers to any unresolved problem that the practitioner had in complying with these attestation standards, interpretive standards, or the specific procedures agreed to by the specific user(s). The practitioner should not express an unqualified conclusion unless the engagement has been conducted in accordance with the attestation standards. Such standards will not have been complied with if the practitioner has been unable to apply all the procedures that he or she considers necessary in the circumstances or, when applicable, that have been agreed upon with the user(s).

64. Restrictions on the scope of an engagement, whether imposed by the client or by such other circumstances as the timing of the work or the inability to obtain sufficient evidence, may require the practitioner to qualify the assurance provided, to disclaim any assurance, or to withdraw from the engagement. The reasons for a qualification or disclaimer should be described in the practitioner's report.

65. The practitioner's decision to provide a qualified opinion, to disclaim an opinion, or to withdraw because of a scope limitation depends on an assessment of the effect of the omitted procedure(s) on his or her ability to express assurance on ~~the presentation of the assertions~~. This assessment will be affected by the nature and magnitude of the potential effects of the matters in question, by their significance to the ~~presentation of assertions~~, and by whether the engagement is an examination or a review. If the potential effects ~~relate to many assertions within a presentation of~~ **are pervasive to the** assertion or if the practitioner is performing a review, a disclaimer of opinion or withdrawal is more likely to be appropriate. When restrictions that significantly limit the scope of the engagement are imposed by the client, the practitioner generally should disclaim an opinion on the ~~presentation of assertions~~ or withdraw from the engagement.

66. "Reservations about the ~~presentation of the assertions~~" refers to any unresolved reservation about ***whether the assertion is fairly stated, in all material respects, based on*** ~~the conformity of the presentation of the assertions with~~ established or stated criteria, including the adequacy of the disclosure of material matters. They can result in either a qualified or an adverse ***opinion report***, depending on the materiality of the departure from the criteria against which the assertions ~~were was~~ evaluated.

67. Reservations about the ~~presentation of the assertions~~ may relate to the measurement, form, arrangement, content, or underlying judgments and assumptions applicable to the ~~presentation of assertions and its appended notes~~, including, for example, the terminology used, the amount of detail given, the classification of items, and the bases of amounts set forth. The practitioner considers whether a particular reservation should be the subject of a qualified or an adverse report given the circumstances and facts of which he or she is aware at the time.

68. The fourth standard of reporting is—*The report on an engagement to evaluate an assertion that has been prepared **based on** ~~in conformity with~~ agreed-upon criteria or on an engagement to apply agreed-upon procedures should contain a statement limiting its use to the parties who have agreed upon such criteria or procedures.*

69. Certain reports should be restricted to specified users who have participated in establishing either the criteria against which the assertions ~~were was~~ evaluated (which are not deemed to be "reason-

able” for general distribution—see the third general standard) or the nature and scope of the attest engagement. Such procedures or criteria can be agreed upon directly by the user or through a designated representative. Reports on such engagements should clearly indicate that they are intended solely for the use of the specified parties and may not be useful to others.

Working Papers

70. The practitioner should prepare and maintain working papers in connection with an engagement under the attestation standards; such working papers should be appropriate to the circumstances and the practitioner’s needs on the engagement to which they apply.¹⁴ Although the quantity, type, and content of working papers will vary with the circumstances, they ordinarily should indicate that—

- a. The work was adequately planned and supervised, indicating observance of the first standard of fieldwork
- b. Evidential matter was obtained to provide a reasonable basis for the conclusion or conclusions expressed in the practitioner’s report

71. Working papers are records kept by the practitioner of the work performed, the information obtained, and the pertinent conclusions reached in the engagement. Examples of working papers are work programs, analyses, memoranda, letters of confirmation and representation, abstracts of the entity’s documents, and schedules or commentaries prepared or obtained by the practitioner. Working papers also may be in the form of data stored on tapes, films, or other media.

72. Working papers are the property of the practitioner, and some states have statutes or regulations that designate the practitioner as the owner of the working papers. The practitioner’s rights of ownership, however, are subject to ethical limitations relating to the confidential relationship with the clients.

73. Certain of the practitioner’s working papers may sometimes serve as a useful reference source for his or her client, but the working papers should not be regarded as a part of or a substitute for the client’s records.

14. There is no intention to imply that the practitioner would be precluded from supporting his or her report by other means in addition to working papers.

74. The practitioner should adopt reasonable procedures for safe custody of his or her working papers and should retain them for a period of time sufficient to meet the needs of his or her practice and to satisfy any pertinent legal requirements of records retention.

Attest Services Related to MAS Engagements¹⁵

Attest Services as Part of an MAS Engagement

75. When a practitioner¹⁶ provides an attest service (as defined in this section) as part of an MAS engagement, the Statements on Standards for Attestation Engagements¹⁷ apply only to the attest service. Statements on Standards for Management Advisory Services (SSMASs) apply to the balance of the Management Advisory Services (MAS) engagement.¹⁸

76. When the practitioner determines that an attest service is to be provided as part of an MAS engagement, the practitioner should inform the client of the relevant differences between the two types of services and obtain concurrence that the attest service is to be performed in accordance with the appropriate professional requirements. The MAS engagement letter or an amendment should document the requirement to perform an attest service. The practitioner should take such actions because the professional requirements for an attest service differ from those for a management advisory service.

77. The practitioner should issue separate reports on the attest engagement and the MAS engagement and, if presented in a common binder, the report on the attest engagement or service should be clearly identified and segregated from the report on the MAS engagement.

15. The terminology in this section is based on Statements on Standards for Management Advisory Services. The SSMASs were superseded by Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*, vol. 2, CS sec. 100), effective for engagements accepted on or after January 1, 1992. This section has not been revised to reflect the conforming changes necessary due to the issuance of the SSCS.

16. *Practitioner* is defined in this section to include a proprietor, partner, or shareholder in a public accounting firm and any full- or part-time employee of a public accounting firm, whether certified or not.

17. This refers to SSAE No. 1, *Attestation Standards*, and subsequent statements in that series, as issued by the AICPA.

18. This refers to SSMAS No. 1, *Definitions and Standards for MAS Practice*, and subsequent statements in that series, as issued by the AICPA.

Assertions, Criteria, and Evidence

78. An attest service may involve written assertions, evaluation criteria, or evidential matter developed during a concurrent or prior MAS engagement. A written assertion of another party developed with the practitioner's advice and assistance as the result of such an MAS engagement may be the subject of an attestation engagement, provided the assertion is dependent upon the actions, plans, or assumptions of that other party who is in a position to have an informed judgment about its accuracy. Criteria developed with the practitioner's assistance may be used to evaluate an assertion in an attest engagement, provided such criteria meet the requirements in this Statement. Relevant information obtained in the course of a concurrent or prior MAS engagement may be used as evidential matter in an attest engagement, provided the information satisfies the requirements of this Statement.

Nonattest Evaluations of Written Assertions

79. The evaluation of statements contained in a written assertion of another party when performing a management advisory service does not in and of itself constitute the performance of an attest service. For example, in the course of an engagement to help a client select a computer that meets the client's needs, the practitioner may evaluate written assertions from one or more vendors, performing some of the same procedures as required for an attest service. However, the MAS report will focus on whether the computer meets the client's needs, not on the reliability of the vendor's assertions. Also, the practitioner's study of the computer's suitability will not be limited to what is in the written assertion of the vendors. Some or all of the information provided in the vendors' written proposals, as well as other information, will be evaluated to recommend a system suitable to the client's needs. Such evaluations are necessary to enable the practitioner to achieve the purpose of the MAS engagement.

Effective Date

80. Paragraphs 1 through 34 and 36 through 69 are effective for attest reports issued on or after September 30, 1986. Earlier application is encouraged. Paragraph 35 is effective for engagements for periods ending on or after June 15, 1998. Earlier application is per-

mitted. Paragraphs 70 through 74 are effective for engagements beginning after December 15, 1995. Paragraphs 75 through 79 are effective for attest reports issued on or after May 1, 1988. ***The amendments to this Statement are effective for reports issued on or after June 30, 1999; earlier application is encouraged.***

Amendment to Statement on Standards for Attestation Engagements No. 2, Reporting on an Entity's Internal Control Over Financial Reporting

(Amends Statement on Standards for Attestation Engagements No. 2, AICPA, Professional Standards, vol. 1, AT sec. 400)

1222222

Applicability

1. This Statement provides guidance to the practitioner who is engaged to examine ~~and report on~~ management's written assertion about the effectiveness of an entity's internal control over financial reporting¹ as of a point in time **and to issue a report on such examination.**² Specifically, guidance is provided regarding the following:

- a. Conditions that must be met for a practitioner to examine ~~and report on~~ management's assertion about the effectiveness of an entity's internal control (paragraph 9); the prohibition of acceptance of an engagement to review ~~and report on~~ such a management assertion (paragraph 6)
- b. Engagements to examine ~~and report on~~ management's assertion about the design and operating effectiveness of an entity's internal control (paragraphs 14 through 64)
- c. Engagements to examine ~~and report on~~ management's assertion about the design and operating effectiveness of a segment of an entity's internal control (paragraph 65)
- d. Engagements to examine ~~and report on~~ management's assertion about only the suitability of design of an entity's internal control (no assertion is made about the operating effectiveness of the internal control) (paragraphs 66 and 67)

1. This Statement does not change the auditor's responsibility for considering the entity's internal control in an audit of the financial statements. See paragraphs 77 through 80.

2. Ordinarily, **the practitioner will be engaged to examine management's assertion about** ~~management will present its assertion about~~ the effectiveness of the entity's internal control over financial reporting as of the end of the entity's fiscal year; however, management may select a different date for its assertion. A practitioner may also be engaged to examine ~~and report on~~ management's assertion about the effectiveness of an entity's internal control during a period of time. In that case, the guidance in this Statement should be modified accordingly.

- e. Engagements to examine ~~and report on~~ management's assertion about the design and operating effectiveness of an entity's internal control based on criteria established by a regulatory agency (paragraphs 68 through 72)

This Statement does *not* provide guidance for the following:

- a. Engagements to examine ~~and report on~~ management's assertion about controls over operations or compliance with laws and regulations³
- b. Agreed-upon procedures engagements (except as noted in paragraph 5)
- c. Certain other services in connection with an entity's internal control covered by other authoritative guidance (paragraph 7 and the Appendix [paragraph 83])
- d. Consulting engagements (paragraph 8)
- e. Engagements to gather data for management (paragraphs 10 and 19)

2. An entity's internal control over financial reporting⁴ includes those policies and procedures that pertain to an entity's ability to record, process, summarize, and report financial data consistent with the assertions embodied in either annual financial statements or interim financial statements, or both. A practitioner engaged to examine ~~and report on~~ management's assertion about the effectiveness of an entity's internal control should comply with the general, fieldwork, and reporting standards in Statement on Standards for Attestation Engagements (SSAE) No. 1, *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 100),

3. A practitioner engaged to examine management's assertion about the effectiveness of an entity's internal control over operations or compliance with laws and regulations should refer to the guidance in Statement on Standards for Attestation Engagements (SSAE) No. 1, *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100). A practitioner engaged to perform agreed-upon procedures on management's assertion relating to an entity's internal control over operations or compliance with laws and regulations should refer to the guidance in SSAE No. 4, *Agreed-Up Procedures Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec. 600). In addition, the guidance in SSAE No. 3, *Compliance Attestation* (AICPA, *Professional Standards*, vol. 1, AT sec. 500), may be helpful when performing an engagement relating to internal control over compliance with laws and regulations. Further, the guidance in this Statement may be helpful in attestation engagements to report on management's assertion about internal control over operations or compliance with laws and regulations.

4. Throughout this Statement, an entity's internal control over financial reporting is referred to as its *internal control*.

and the specific performance and reporting standards set forth in this Statement.⁵

3. Management may present its written assertion about the effectiveness of the entity's internal control in either of two forms:

- a. A separate report that will accompany the practitioner's report
- b. A representation letter to the practitioner ~~(in this case, however, the practitioner should restrict the use of his or her report to management and others within the entity and, if applicable, to specified regulatory agencies)~~

~~A practitioner should not consent to the use of his or her examination report on management's assertion about the effectiveness of an entity's internal control in a general-use document unless management presents its written assertion in a separate report that will accompany the practitioner's report. **If management's assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of management's assertion.**~~

4. Management's written assertion about the effectiveness of an entity's internal control may take various forms. Throughout this Statement, for example, the phrase, "management's assertion that W Company maintained effective internal control over financial reporting as of [date]," illustrates such an assertion. Other phrases, such as "management's assertion that W Company's internal control over financial reporting is sufficient to meet the stated objectives," may also be used. However, a practitioner should not provide assurance on an assertion that is so subjective (for example, "very effective" internal control) that people having competence in and using the same or similar measurement and disclosure criteria would not ordinarily be able to arrive at similar conclusions.

Other Attest Services

5. A practitioner may also be engaged to provide other types of services in connection with an entity's internal control. For example, he or she may be engaged to *perform agreed-upon procedures* relating to

5. Practitioners engaged to examine and report on the design and/or operating effectiveness of the internal control of a service organization should refer to Statement on Auditing Standards (SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA, Professional Standards, vol. 1, AU sec. 324).

management's assertion about the effectiveness of the entity's internal control. For such engagements, the practitioner should refer to the guidance in SSAE No. ~~1~~ 4. However, notwithstanding the guidance set forth in SSAE No. ~~1~~ 4, a practitioner's report on agreed-upon procedures related to management's assertion about the effectiveness of the entity's internal control should be in the form of procedures and findings. The practitioner should not provide negative assurance about whether management's assertion is fairly stated.

6. Although a practitioner may *examine* or *perform agreed-upon procedures* relating to management's assertion about the effectiveness of the entity's internal control, he or she should not accept an engagement to *review* ~~and report on~~ such a management assertion.

7. The Appendix (paragraph 83) presents a listing of authoritative guidance for a practitioner engaged to provide other services in connection with an entity's internal control. Under the Securities Exchange Act of 1934, certain reports on the entity's internal control are required. Rule 17a-5 requires such a report for a broker or dealer in securities. The AICPA Audit and Accounting Guide *Brokers and Dealers in Securities* contains a sample report that a practitioner might use in such circumstances. In addition, Form N-SAR requires a report on the internal control of an investment company. A sample report that a practitioner might use in such situations is included in the Audit and Accounting Guide *Audits of Investment Companies*, published by the AICPA. Such information, included in the Appendix (paragraph 83) to this Statement, in Rule 17a-5, and in Form N-SAR, is not covered by this Statement.

Nonattest Services

8. The guidance in this Statement does not apply if management does not ***provide the practitioner with a written assertion*** ~~present a written assertion. In this situation, there is no assertion by management on which the practitioner can provide assurance.~~ However, management may engage the practitioner to provide certain nonattest services in connection with the entity's internal control. For example, management may engage the practitioner to provide recommendations on improvements to the entity's internal control. A practitioner engaged to provide such nonattest services should refer to the guidance in the Statement on Standards for Consulting Services (SSCS)

No. 1, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*, vol. 1, CS section 100).

Conditions for Engagement Performance

9. A practitioner may ~~examine and report on~~ management's assertion about the effectiveness of an entity's internal control if the following conditions are met:

- a. Management accepts responsibility for the effectiveness of the entity's internal control.
- b. Management evaluates the effectiveness of the entity's internal control using reasonable criteria for effective internal control established by a recognized body. Such criteria are referred to as *control criteria* throughout this Statement.⁶
- c. Sufficient evidential matter exists or could be developed to support management's evaluation.
- d. Management ~~provides to the practitioner~~ **presents** its written assertion, ~~as discussed in paragraph .03,~~ about the effectiveness of the entity's internal control based upon the control criteria referred to in its report.

10. Management is responsible for establishing and maintaining effective internal control. In some cases, management may evaluate and report on the effectiveness of internal control without the practitioner's assistance. However, management may engage the practitioner

6. Criteria issued by the AICPA, regulatory agencies, and other bodies composed of experts that follow due process procedures, including procedures for broad distribution of proposed criteria for public comment, usually should be considered reasonable criteria for this purpose. For example, the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's report, *Internal Control-Integrated Framework*, provides reasonable criteria against which management may evaluate and report on the effectiveness of the entity's internal control.

Criteria established by groups that do not follow due process or groups that do not as clearly represent the public interest should be viewed more critically. The practitioner should judge whether such criteria are reasonable for general distribution reporting by evaluating them against the elements in SSAE No. 1, paragraph 18. If the practitioner determines that such criteria are reasonable for general distribution reporting, such criteria should be stated in the ~~presentation of the~~ assertion in a sufficiently clear and comprehensive manner for a reader to be able to understand them.

Some criteria are reasonable for only the parties who have participated in establishing them; for example, criteria established by a regulatory agency for its specific use. When such criteria are used, they are not suitable for general distribution reporting and the practitioner should modify his or her report by adding a paragraph that limits the report distribution to the specific parties who have participated in establishing the criteria.

to gather information to enable management to evaluate the effectiveness of the entity's internal control.

Components of an Entity's Internal Control

11. The components that constitute an entity's internal control are a function of the definition and description of internal control selected by management for the purpose of assessing its effectiveness. For example, management may select the definition and description of internal control based on the internal control framework set forth in *Internal Control—Integrated Framework*,⁷ published by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.⁸ *Internal Control—Integrated Framework* describes an entity's internal control as consisting of five components: control environment, risk assessment, control activities, information and communication, and monitoring. If management selects another definition and description of internal control, these components may not be relevant.

Limitations of an Entity's Internal Control

12. Internal control, no matter how well designed and operated, can provide only reasonable assurance to management and the board of directors regarding achievement of an entity's control objectives. The likelihood of achievement is affected by limitations inherent to internal control. These include the realities that human judgment in decision-making can be faulty, and that breakdowns in internal control can occur because of such human failures as simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people or management override of internal control.

13. Custom, culture, and the corporate governance system may inhibit fraud by management, but they are not absolute deterrents. An effective control environment, too, may help mitigate the probability of such fraud. For example, an effective board of directors, audit committee, and an internal audit function may constrain improper

7. As noted in footnote 6, this report also contains control criteria.

8. This definition and description is consistent with the definition contained in SAS No. 55, as amended by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 319). However, SAS No. 55, as amended by SAS No. 78, is not intended to provide criteria for evaluating internal control effectiveness.

conduct by management. Alternatively, an ineffective control environment may negate the effectiveness of the other components. For example, when the presence of management incentives creates an environment that could result in material misstatement of financial statements, the effectiveness of control activities may be reduced. The effectiveness of an entity's internal control might also be adversely affected by such factors as a change in ownership or control, changes in management or other personnel, or developments in the entity's market or industry.

Examination Engagement

14. The practitioner's objective in an engagement to examine ~~and report on~~ management's assertion about the effectiveness of the entity's internal control is to express an opinion ~~on about whether management's assertion regarding~~ ***(a) the effectiveness of the entity's internal control, in all material respects, is fairly stated, in all material respects, based upon the control criteria or (b) whether management's assertion about the effectiveness of internal control is fairly stated, in all material respects, based on the control criteria.*** The practitioner's opinion relates to ~~the fair presentation of management's assertion about~~ the effectiveness of the entity's internal control taken as a whole, and not to the effectiveness of each individual component (control environment, risk assessment, control activities, information and communication, and monitoring) of the entity's internal control.⁹ Therefore, the practitioner considers the interrelationship of the components of an entity's internal control in achieving the objectives of the control criteria. To express an opinion ~~on management's assertion~~, the practitioner accumulates sufficient evidence about the design effectiveness and operating effectiveness of the entity's internal control ~~to attest to management's assertion~~, thereby limiting attestation risk to an appropriately low level. When evaluating the design effectiveness of specific controls, the practitioner considers whether the control is suitably designed to prevent or detect material misstatements on a timely basis. When evaluating operating effectiveness, the practitioner considers how the control was applied, the consistency with which it was applied, and by whom it was applied.

9. However, as discussed in paragraph 65, management's assertion may relate to a segment of its internal control.

15. Performing an examination of management's assertion about the effectiveness of an entity's internal control involves (a) planning the engagement, (b) obtaining an understanding of internal control, (c) evaluating the design effectiveness of the controls, (d) testing and evaluating the operating effectiveness of the controls and (e) forming an opinion ~~on about whether management's assertion regarding the effectiveness of the entity's internal control, or management's assertion thereon, is fairly stated, in all material respects,~~ based on the control criteria.

Planning the Engagement

General Considerations

16. Planning an engagement to examine ~~and report on~~ management's assertion about the effectiveness of the entity's internal control involves developing an overall strategy for the scope and performance of the engagement. When developing an overall strategy for the engagement, the practitioner should consider factors such as the following:

- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Knowledge of the entity's internal control obtained during other professional engagements
- Matters relating to the entity's business, including its organization, operating characteristics, capital structure, and distribution methods
- The extent of recent changes, if any, in the entity, its operations, or its internal control
- Management's method of evaluating the effectiveness of the entity's internal control based upon control criteria
- Preliminary judgments about materiality levels, inherent risk, and other factors relating to the determination of material weaknesses
- The type and extent of evidential matter supporting management's assertion about the effectiveness of the entity's internal control
- The nature of specific controls designed to achieve the objectives of the control criteria, and their significance to internal control taken as a whole
- Preliminary judgments about the effectiveness of internal control

Multiple Locations

17. A practitioner planning an engagement to examine management's assertion ~~about~~ **on** the effectiveness of the internal control of an entity with operations in several locations should consider factors similar to those he or she would consider in performing an audit of the financial statements of an entity with multiple locations. It may not be necessary to understand and test controls at each location. In addition to the factors listed in paragraph 16, the selection of locations should be based on factors such as (a) the similarity of business operations and internal control at the various locations, (b) the degree of centralization of records, (c) the effectiveness of the control environment, particularly management's direct control over the exercise of authority delegated to others and its ability to effectively supervise activities at the various locations, and (d) the nature and amount of transactions executed and related assets at the various locations.

Internal Audit Function

18. Another factor the practitioner should consider when planning the engagement is whether the entity has an internal audit function. An important responsibility of the internal audit function is to monitor the performance of an entity's controls. One way internal auditors monitor such performance is by performing tests that provide evidence about the effectiveness of the design and operation of specific controls. The results of these tests are often an important basis for management's assertions about the effectiveness of the entity's internal control. A practitioner should consider the guidance in SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 322), when assessing the competence and objectivity of internal auditors, the extent of work to be performed, and other matters.

Documentation

19. Controls and the control objectives that they were designed to achieve should be appropriately documented to serve as a basis for management's **assertion** and the practitioner's reports. Such documentation is generally prepared by management. However, at management's request, the practitioner may assist in preparing or gathering such documentation. This documentation may take various forms: entity policy manuals, accounting manuals, narrative memoranda, flowcharts, decision tables, procedural write-ups, or completed ques-

tionnaires. No one particular form of documentation is necessary, and the extent of documentation may vary depending upon the size and complexity of the entity.

Obtaining an Understanding of the Internal Control

20. A practitioner generally obtains an understanding of the design of specific controls by making inquiries of appropriate management, supervisory, and staff personnel; by inspecting entity documents; and by observing entity activities and operations. The nature and extent of the procedures a practitioner performs vary from entity to entity and are influenced by factors such as those discussed in paragraph 16.

Evaluating the Design Effectiveness of Controls

21. To evaluate the design effectiveness of an entity's internal control, the practitioner should obtain an understanding of the controls within each component of internal control.¹⁰

22. Any of the ~~elements~~ **components** of internal control may include controls designed to achieve the objectives of the control criteria. Some controls may have a pervasive effect on achieving many overall objectives of these criteria. For example, computer general controls over program development, program changes, computer operations, and access to programs and data help assure that specific controls over the processing of transactions are operating effectively. In contrast, other controls are designed to achieve specific objectives of the control criteria. For example, management generally establishes specific controls, such as accounting for all shipping documents, to ensure that all valid sales are recorded.

23. The practitioner should focus on the significance of controls in achieving the objectives of the control criteria rather than on specific controls in isolation. The absence or inadequacy of a specific control designed to achieve the objectives of a specific criterion may not be a deficiency if other controls specifically address the same criterion.

10. As discussed in paragraph 11, the components that constitute an entity's internal control are a function of the definition and description of internal control selected by management. Paragraph 11 lists the components the practitioner should understand if management decides to evaluate ~~and report on~~ the entity's internal control based on the definition of internal control in *Internal Control—Integrated Framework*. If management selects another definition, these components may not be relevant.

Further, when one or more control achieves the objectives of a specific criterion, the practitioner may not need to consider other controls designed to achieve those same objectives.

24. Procedures to evaluate the effectiveness of the design of a specific control are concerned with whether that control is suitably designed to prevent or detect material misstatements in specific financial statement assertions. Such procedures will vary depending upon the nature of the specific control, the nature of the entity's documentation of the specific control, and the complexity and sophistication of the entity's operations and systems.

Testing and Evaluating the Operating Effectiveness of Controls

25. To evaluate the operating effectiveness of an entity's internal control, the practitioner performs tests of relevant controls to obtain sufficient evidence to support the opinion in the report. Tests of the operating effectiveness of a control are concerned with how the control was applied, the consistency with which it was applied, and by whom it was applied. The tests ordinarily include procedures such as inquiries of appropriate personnel, inspection of relevant documentation, observation of the entity's operations, and reapplication or reperformance of the control.

26. The evidential matter that is sufficient to support a practitioner's opinion ~~on management's assertion~~ is a matter of professional judgment. However, the practitioner should consider matters such as the following:

- The nature of the control
 - The significance of the control in achieving the objectives of the control criteria
 - The nature and extent of tests of the operating effectiveness of the controls performed by the entity, if any
 - The risk of noncompliance with the control, which might be assessed by considering the following:
 - Whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness
 - Whether there have been changes in controls
-

- The degree to which the control relies on the effectiveness of other controls (for example, the control environment or computer general controls)
- Whether there have been changes in key personnel who perform the control or monitor its performance
- Whether the control relies on performance by an individual or by electronic equipment
- The complexity of the control
- Whether more than one control achieves a specific objective

27. Management or other entity personnel may provide the practitioner with the results of their tests of the operating effectiveness of certain controls. Although the practitioner should consider the results of such tests when evaluating the operating effectiveness of controls, it is the practitioner's responsibility to obtain sufficient evidence to support his or her opinion and, if applicable, corroborate the results of such tests. When evaluating whether sufficient evidence has been obtained, the practitioner should consider that evidence obtained through his or her direct personal knowledge, observation, reperformance, and inspection is more persuasive than information obtained indirectly, such as from management or other entity personnel. Further, judgments about the sufficiency of evidence obtained and other factors affecting the practitioner's opinion, such as the materiality of identified control deficiencies, should be those of the practitioner.

28. The nature of the controls influences the nature of the tests of controls the practitioner can perform. For example, the practitioner may examine documents regarding controls for which documentary evidence exists. However, documentary evidence regarding the control environment (such as management's philosophy and operating style) often does not exist. In these circumstances, the practitioner's tests of controls would consist of inquiries of appropriate personnel and observation of entity activities. The practitioner's preliminary judgments about the effectiveness of the control environment often influence the nature, timing, and extent of the tests of controls to be performed to obtain evidence about the operating effectiveness of controls in the accounting system and other controls.

29. The period of time over which the practitioner should perform tests of controls is a matter of judgment; however, it varies with

the nature of the controls being tested and with the frequency with which specific controls operate and specific policies are applied. Some controls operate continuously (for example, controls over sales) while others operate only at certain times (for example, controls over the preparation of interim financial statements and controls over physical inventory counts). The practitioner should perform tests of controls over a period of time that is adequate to determine whether, as of the date selected by management for its assertion, the controls necessary for achieving the objectives of the control criteria are operating effectively.

30. Management may ***request the practitioner to examine management's present a written*** assertion about the effectiveness of controls related to the preparation of interim financial information. Depending on ***the period(s) selected by management management's assertion,*** the practitioner should perform tests of controls in effect during one or more interim periods to form an opinion about the effectiveness of such controls in achieving the related interim reporting objectives.

31. Prior to the date as of which ***management's assertion about internal control over financial reporting is made it pre-*** ~~sents its assertion~~, management may change the entity's controls to make them more effective or efficient, or to address control deficiencies. In these circumstances, the practitioner may not need to consider controls that have been superseded. For example, if the practitioner determines that the new controls achieve the related objectives of the control criteria and have been in effect for a sufficient period to permit the practitioner to assess their design and operating effectiveness by performing tests of controls, the practitioner will not need to consider the design and operating effectiveness of the superseded controls.

Forming an Opinion on Management's Assertion

32. When forming an opinion on ~~management's assertion about~~ the effectiveness of an entity's internal control ***or management's assertion thereon,*** the practitioner should consider all evidence obtained, including the results of the tests of controls and any identified control deficiencies, to evaluate the design and operating effectiveness of the controls based on the control criteria.

Deficiencies in an Entity's Internal Control

33. During the course of the engagement, the practitioner may become aware of significant deficiencies in the entity's internal control. The practitioner's responsibility to communicate such deficiencies is described in paragraphs 39 and 40.

Reportable Conditions

34. SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, Professional Standards, vol. 1, AU sec. 325), defines reportable conditions as matters coming to an auditor's attention that represent significant deficiencies in the design or operation of internal control that could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Material Weaknesses

35. A reportable condition may be of such magnitude as to be considered a material weakness. SAS No. 60 defines a material weakness as a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Therefore, the presence of a material weakness will preclude **the practitioner from concluding** ~~management from asserting~~ that the entity has effective internal control. However, depending on the significance of the material weakness and its effect on the achievement of the objectives of the control criteria, **the practitioner** ~~management~~ may qualify **his or her opinion** ~~its assertion~~ (that is, **express an opinion that** ~~assert that~~ internal control is effective "except for" the material weakness noted) **or may express an adverse opinion.**¹¹

36. When evaluating whether a reportable condition is also a material weakness, the practitioner should recognize that—

11. Paragraphs 47 through 54 contain guidance the practitioner should consider when ~~reporting on a management assertion that contains, or should contain, a description of a material weakness exists.~~

- a. The amounts of misstatements caused by error or fraud that might occur and remain undetected range from zero to more than the gross financial statement amounts or transactions that are exposed to the reportable condition.
- b. The risk of misstatement due to error or fraud is likely to be different for the different possible amounts within that range. For example, the risk of misstatement due to error or fraud in amounts equal to the gross exposure might be very low, but the risk of smaller amounts might be progressively greater.

37. In evaluating whether the combined effect of individual reportable conditions results in a material weakness, the practitioner should consider—

- a. The range or distribution of the amounts of misstatement caused by error or fraud that may result during the same accounting period from two or more individual reportable conditions.
- b. The joint risk or probability that such a combination of misstatements would be material.

38. Evaluating whether a reportable condition is also a material weakness is a subjective process that depends on such factors as the nature of the accounting system and of any financial statement amounts or transactions exposed to the reportable condition, the overall control environment, other controls, and the judgment of those making the evaluation.

Communicating Reportable Conditions and Material Weaknesses

39. A practitioner engaged to examine ~~and report on~~ management's assertion about the effectiveness of the entity's internal control should communicate reportable conditions to the audit committee¹² and identify the reportable conditions that are also considered to be material weaknesses. Such a communication should preferably be made in writing. Because of the potential for misinterpretation of the limited degree of assurance associated with the auditor issuing a written report representing that no reportable con-

12. If the entity does not have an audit committee, the practitioner should communicate with individuals whose authority and responsibility are equivalent to those of an audit committee, such as the board of directors, the board of trustees, an owner in an owner-managed entity, or those who engaged the practitioner.

ditions were noted during the examination, the auditor should not issue such representations.

40. Because timely communication may be important, the practitioner may choose to communicate significant matters during the course of the examination rather than after the examination is concluded. The decision about whether an interim communication should be issued would be influenced by the relative significance of the matters noted and the urgency of corrective follow-up action.

Management's Representations

41. The practitioner should obtain written representations from management—¹³

- a. Acknowledging management's responsibility for establishing and maintaining internal control.
- b. Stating that management has performed an evaluation of the effectiveness of the entity's internal control and specifying the control criteria used.
- c. Stating management's assertion about the effectiveness of the entity's internal control based ~~upon~~ the control criteria **as of a specified date**.
- d. Stating that management has disclosed to the practitioner all significant deficiencies in the design or operation of internal control which could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements and has identified those that it believes to be material weaknesses in internal control.
- e. Describing any material fraud and any other fraud that, although not material, involve management or other employees who have a significant role in the entity's internal control.
- f. Stating whether there were, subsequent to the date **being reported on** ~~of management's report~~, any changes in internal control or other factors that might significantly affect internal control, including any corrective actions taken by management with regard to significant deficiencies and material weaknesses.

13. SAS No. 85, *Management Representations* (AICPA, *Professional Standards*, vol. 1, AU sec. 333), provides guidance on the date as of which management should sign such a representation letter and which member(s) of management should sign it.

42. Management's refusal to furnish all appropriate written representations constitutes a limitation on the scope of the examination sufficient to require a qualified opinion or disclaimer of opinion on management's assertion about the effectiveness of the entity's internal control. Further, the practitioner should consider the effects of management's refusal on his or her ability to rely on other management representations.

Reporting Standards

43. ~~The form of the practitioner's report depends on the manner in which management presents its written assertion:~~

- ~~a. If management's assertion is presented in a separate report that accompanies the practitioner's report, the practitioner's report is considered appropriate for general distribution and the practitioner should use the form of report discussed in paragraphs .45 and .46.~~
- ~~b. If management presents its assertion only in a representation letter to the practitioner, the practitioner should restrict the distribution of his or her report to management, to others within the entity, and, if applicable, to specified regulatory agencies, and the practitioner should use the form of report discussed in paragraphs .47 through .49.~~

Management's Assertion Presented in a Separate Report

43. ~~When management presents its assertion in a separate report that will accompany the practitioner's report, the~~ **The** practitioner's report should ***include the following:***

- a. A title that includes the word independent*
- b. An identification of management's assertion about the effectiveness of the entity's internal control over financial reporting **as of a specified date (When management's assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of management's assertion.)***
- c. A statement that the assertion is the responsibility of management*

- d. ***A statement that the practitioner's responsibility is to express an opinion on [the effectiveness of an entity's internal control or management's assertion] based on his or her examination***
- ee. A statement that the examination was ~~conducted~~ **made** in accordance with **attestation** standards established by the **American Institute of Certified Public Accountants AICPA** and, accordingly, ~~that it~~ included obtaining an understanding of internal control over financial reporting, testing and evaluating the design and operating effectiveness of internal control, and performing other such procedures as the practitioner considered necessary in the circumstances (In addition, the report should include a statement that the practitioner believes the examination provides a reasonable basis for his or her opinion.)
- f. ***A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion.***
- ge. A paragraph stating that, because of inherent limitations of any internal control, misstatements due to errors or fraud may occur and not be detected (In addition, the paragraph should state that projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.)
- he. The practitioner's opinion on whether ***(1) the entity has maintained, in all material respects, management's assertion about the effectiveness of the entity's effective*** internal control over financial reporting as of the specified date ~~is fairly stated, in all material respects,~~ ***based on the control criteria or (2) management's assertion about the effectiveness of the entity's internal control over financial reporting as of the specified date is fairly stated, in all material respects, based on the control criteria.***¹⁴
- i. ***If the assertion has been prepared in conformity with criteria specified by a regulatory agency (see paragraph 68) or that have been agreed upon by the asserter and the specified parties, the practitioner's report should also contain—***

14. See paragraph 47 for reporting when the examination discloses conditions that, individually or in combination, result in one or more material weaknesses.

- ***A statement of limitations on the use of the report because it is intended solely for specified parties (see the fourth reporting standard)***
 - ***A statement, when established criteria exist, that the assertion is not intended to be that which would have been presented if the assertion were presented based on [identify established criteria]***
- j. ***The manual or printed signature of the practitioner's firm***
- k. ***The date of the examination report***

44. The following is the form of report a practitioner should use when he or she ~~has examined management's assertion~~ ***expresses an opinion directly on about*** the effectiveness of an entity's internal control as of a specified date.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion ~~[identify management's assertion, for example, included in the accompanying [title of management report], that W Company maintained effective internal control over financial reporting as of December 31, 19XX]~~ ***included in the accompanying [title of management report], based on [identify stated or established criteria].¹⁵ Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.***

[Scope paragraph]

Our examination was ~~made~~ ***conducted*** in accordance with ***attestation*** standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and ***performing*** such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

15. The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its reports, including the types of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. ***If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.***

[Inherent limitations paragraph]

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

[Opinion paragraph]

In our opinion, ~~management's assertion [identify management's assertion, for example, that W Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 19XX] is fairly stated, in all material respects,~~ based upon [identify stated or established criteria].¹⁶

[Signature]

[Date]

45. The following is the form of report a practitioner should use when he or she expresses an opinion on management's assertion about the effectiveness of an entity's internal control as of a specified date.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, included in the accompanying [title of management report], that W Company maintained effective internal control over financial reporting as of December 31, 19XX based on [identify stated or established criteria].¹⁷ Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on management's assertion based on our examination.

[Standard scope and inherent limitations paragraphs]

16. For example, "criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

17. *The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.*

[Opinion paragraph]

In our opinion, management's assertion that W Company maintained effective internal control over financial reporting as of December 31, 19XX is fairly stated, in all material respects, based on [identify stated or established criteria].¹⁸

[Signature]

[Date]

~~Management's Assertion Presented Only in a Letter of Representation to the Practitioner~~

~~47. Sometimes, management may present its written assertion about the effectiveness of the entity's internal control in a representation letter to the practitioner but not in a separate report that accompanies the practitioner's report. For example, an entity's board of directors may request the practitioner to report on management's assertion without requiring management to present a separate written assertion.~~

~~48. When management does not present a written assertion that accompanies the practitioner's report, the practitioner should modify the report to include management's assertion about the effectiveness of the entity's internal control and add a paragraph that limits the distribution of the report to management, to others within the entity, and, if applicable, to a specified regulatory agency.~~

~~49. A sample report that a practitioner might use in such circumstances follows.~~

Independent Accountant's Report

[Introductory paragraph]

~~We have examined management's assertion, included in its representation letter dated February 15, 19XX, that [identify management's assertion, for example, W Company maintained effective internal control over financial reporting as of December 31, 19XX].~~

~~*[Standard scope, inherent limitations, and opinion paragraphs]*~~

[Limitation on distribution paragraph]

~~This report is intended solely for the information and use of the board of directors and management of W Company [and, if applica-~~

¹⁸ For example, "criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

~~ble, a specified regulatory agency] and should not be used for any other purpose.⁴⁰~~

Report Modifications

46. The practitioner should modify the standard reports ~~in paragraphs 46 and 49~~ if any of the following conditions exist:

- a. There is a material weakness in the entity's internal control (paragraphs 47 through 54).
- b. There is a restriction on the scope of the engagement (paragraphs 55 through 58).
- c. The practitioner decides to refer to the report of another practitioner as the basis, in part, for the practitioner's own report (paragraphs 59 and 60).
- d. A significant subsequent event has occurred since the date ~~of being reported on management's assertion~~ (paragraphs 61 through 64).
- e. Management's ~~presents an~~ assertion ~~about~~ **relates to** the effectiveness of only a segment of the entity's internal control (paragraph 65).
- f. Management's ~~presents an~~ assertion only **relates to** ~~about~~ the suitability of design of the entity's internal control (paragraphs 66 and 67).
- g. Management's assertion is based upon criteria established by a regulatory agency without following due process (paragraphs 68 through 72).

Material Weaknesses

47. If the examination discloses conditions that, individually or in combination, result in one or more material weaknesses (paragraphs 35 through 38), the practitioner should modify the report **and, to most effectively communicate with the reader of the report, should express his or her opinion directly on the effectiveness of internal control, not on management's assertion.** The nature of the modification depends on whether management includes in its assertion a description of the weakness and its effect on the achievement of the objectives of the control criteria.

~~10. If the report is a matter of public record, the following sentence should be added: "However, this report is a matter of public record and its distribution is not limited."~~

Management Includes the Material Weakness in Its Assertion

48. If management includes in ***its representation to the practitioner and*** its assertion a description of the weakness and its effect on the achievement of the objectives of the control criteria, and if it appropriately modifies its assertion about the effectiveness of the entity's internal control in light of that weakness, the practitioner should both modify the opinion paragraph by including a reference to the material weakness and add an explanatory paragraph (~~following~~ ***preceding*** the opinion paragraph) that describes the weakness.¹⁹

49. The following is the form of the report, modified with explanatory language, that a practitioner should use when management includes in its assertion a description of the weakness and its effect on the achievement of the objectives of the control criteria, and when it appropriately modifies its assertion about the effectiveness of the entity's internal control in light of that weakness.

Independent Accountant's Report

~~[Standard introductory, scope, and inherent limitations paragraphs]~~

~~[Opinion paragraph]~~

~~In our opinion, management's assertion that, except for the effect of the material weakness described in its report, [identify management's assertion, for example, W Company maintained effective internal control over financial reporting as of December 31, 19XX] is fairly stated, in all material respects, based upon [identify established or stated criteria].~~

~~[Explanatory paragraph]~~

~~As discussed in management's assertion, the following material weakness exists in the design or operation of the internal control of W Company in effect at [date]. [Describe the material weakness and its effect on the achievement of the objectives of the control criteria.]²⁰ A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis.~~

19. As stated in paragraph 35, the existence of a material weakness precludes ***the practitioner from concluding management from asserting*** that an entity's internal control is effective.

20. The language used by the practitioner ordinarily should conform with management's description of the effect of the material weakness on the effectiveness of the entity's internal control.

[Introductory paragraph]

We have examined management's assertion, included in the accompanying [title of management report] that, except for the material weakness described below, W Company has maintained effective internal control over financial reporting as of December 31, 19XX, based on [identify stated or established criteria].²⁰ Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

*[Standard scope and inherent limitations paragraphs]**[Explanatory paragraph]*

[Include sentence(s) describing the material weakness and its effect on the achievement of the objectives of the control criteria and a statement that the condition represents a material weakness.] A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis.²¹

[Opinion paragraph]

In our opinion, except for the effect of the material weakness described in the preceding paragraph on the achievement of the objectives of the control criteria, W Company has maintained, in all material respects, effective internal control over financial reporting as of December 31, 19XX, based on [identify established or stated criteria].

[Signature]

[Date]

50. The following is the form of report, expressing an adverse opinion, that a practitioner should use when management includes in its assertion to the practitioner a description of the

20. The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.

21. This description of a material weakness differs from the definition of material weakness discussed in paragraph 35. Although a practitioner should consider the definition contained in paragraph 35 when determining whether a material weakness exists, the description above should be used to describe a material weakness in the practitioner's report.

weakness and its effect on the achievement of the objectives of the control criteria, and when it appropriately modifies its assertion about the effectiveness of the entity's internal control in light of that weakness. An adverse opinion is expressed when, in the practitioner's judgment, the material weakness(es) is (are) so pervasive that the entity's internal control over financial reporting does not achieve the control objectives.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, included in the accompanying [title of management report], that, because of the effect of the material weakness described below, W Company has not maintained effective internal control over financial reporting as of December 31, 19XX, based on [identify stated or established criteria].²² Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

[Standard scope and inherent limitations paragraphs]

[Explanatory paragraph]

[Include sentence(s) describing the material weakness and its effect on the achievement of the objectives of the control criteria and a statement that the condition represents a material weakness.] A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis.²³

[Opinion paragraph]

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, W Company has not maintained effective internal

22. The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.

23. This description of a material weakness differs from the definition of material weakness discussed in paragraph 35. Although a practitioner should consider the definition contained in paragraph 35 when determining whether a material weakness exists, the description above should be used to describe a material weakness in the practitioner's report.

control over financial reporting as of December 31, 19XX, based on [identify established or stated criteria].

[Signature]

[Date]

Disagreements With Management

51. In some circumstances, management may disagree with the practitioner over the existence of a material weakness and, therefore, not include in its assertion **an appropriate** a description of such a weakness and its effect on the achievement of the objectives of the control criteria. In other circumstances, management may describe a material weakness but **nevertheless assert** ~~but not modify its assertion~~ that the entity's internal control is effective.²⁴ In such cases, the practitioner should **modify his or her report** ~~express an adverse opinion on management's assertion; an example of an adverse opinion in such a situation is given in paragraph 52.~~

52. The following is the form of the report a practitioner should use when he or she concludes that an adverse opinion is appropriate in the circumstances.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, included in the accompanying [title of management report] that, except for the material weakness described below, W Company has maintained effective internal control over financial reporting as of December 31, 19XX, based on [identify stated or established criteria].²⁴ Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

~~[Standard introductory, scope and inherent limitations paragraphs]~~

[Explanatory paragraph]

²⁴ See footnote 20.

24. The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.

Our examination disclosed the following condition, which we believe is a material weakness in the design or operation of the internal control of W Company in effect at [date]. *[Describe the material weakness and its effect on achievement of the objectives of the control criteria.]* A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis.

[Opinion paragraph]

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, ~~management's assertion [identify management's assertion; for example, that W Company maintained effective internal control over financial reporting as of December 31, 19XX] is not fairly stated based upon [identify established or stated criteria].~~ **W Company did not maintain effective internal control over financial reporting as of December 31, 19XX based on [identify established or stated criteria].**

[Signature]

[Date]

53. If management's assertion **accompanying the practitioner's report** contains a statement that management believes the cost of correcting the weakness would exceed the benefits to be derived from implementing new controls, the practitioner should disclaim an opinion on management's cost-benefit statement. The practitioner may use the following sample language as the last paragraph of the report to disclaim an opinion on management's cost-benefit statement:

We do not express an opinion or any other form of assurance on management's cost-benefit statement.

However, if the practitioner believes that management's cost-benefit statement is a material misstatement of fact, he or she should consider the guidance in paragraphs 74 and 75 and take appropriate action.

~~Management's Assertion Includes the Material Weakness and Is Presented in a Practitioner's Report on Internal Control Identifies a Material Weakness and Is Included in the Same Document Containing the Audit Report~~

54. If the practitioner's ~~issues an examination~~ report on **his or her examination of** management's assertion about the effectiveness of the entity's internal control **is included** within the same document that

includes his or her audit report on the entity's financial statements, the following sentence should be included in the paragraph of the examination report that describes the material weakness.

These conditions were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 19XX financial statements, and this report does not affect our report dated [date of report] on these financial statements.

The practitioner may also include the preceding sentence in situations where the two reports are not included within the same document.

Scope Limitations

55. An unqualified opinion on ~~management's assertion about~~ the effectiveness of the entity's internal control **or management's assertion thereon** can be expressed only if the practitioner has been able to apply all the procedures he or she considers necessary in the circumstances. Restrictions on the scope of the engagement, whether imposed by the client or by the circumstances, may require the practitioner to qualify or disclaim an opinion. The practitioner's decision to qualify or disclaim an opinion because of a scope limitation depends on his or her assessment of the importance of the omitted procedure(s) to his or her ability to form an opinion on ~~management's assertion about~~ the effectiveness of the entity's internal control.

56. For example, management may have implemented controls to correct a material weakness identified prior to the date **of management's assertion** ~~of its assertion~~. However, unless the practitioner has been able to obtain evidence that the new controls were appropriately designed and have been operating effectively for a sufficient period of time,²⁵ he or she should refer to the material weakness ~~described in the report~~ and qualify his or her opinion on the basis of a scope limitation. The following is the form of the report a practitioner should use when restrictions on the scope of the examination cause the practitioner to issue a qualified opinion.

25. See guidance in paragraph 29.

Independent Accountant's Report*[Standard introductory paragraph]**[Scope paragraph]*

Except as described below, our examination was ~~made~~ **conducted** in accordance with **attestation** standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and **performing** such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[Explanatory paragraph]

Our examination disclosed the following material weaknesses in the design or operation of the internal control of W Company in effect at [date]. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. Prior to December 20, 19XX, W Company had an inadequate system for recording cash receipts, which could have prevented the Company from recording cash receipts on accounts receivable completely and properly. Therefore, cash received could have been diverted for unauthorized use, lost, or otherwise not properly recorded to accounts receivable. Although the Company implemented a new cash receipts system on December 20, 19XX, the system has not been in operation for a sufficient period of time to enable us to obtain sufficient evidence about its operating effectiveness.

*[Standard inherent limitations paragraph]**[Explanatory paragraph]*

~~Our examination disclosed the following material weaknesses in the design or operation of the internal control of W Company in effect at [date]. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. Prior to December 20, 19XX, W Company had an inadequate system for recording cash receipts, which could have prevented the Company from recording cash receipts on accounts receivable completely and properly. Therefore, cash received could have been diverted for unauthorized use, lost, or otherwise not properly recorded to accounts receivable. Although the Company implemented a new~~

cash receipts system on December 30, 19XX, the system has not been in operation for a sufficient period of time to enable us to obtain sufficient evidence about its operating effectiveness.

[Opinion paragraph]

In our opinion, except for the effect of matters we may have discovered had we been able to examine evidence about the effectiveness of the new cash receipts system, ~~management's assertion [identify management's assertion, for example, that W Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 19XX] is fairly stated, in all material respects, based upon [identify established or stated criteria].~~

[Signature]

[Date]

57. When restrictions that significantly limit the scope of the examination are imposed by the client, the practitioner generally should disclaim an opinion on ~~management's assertion about the effectiveness of the entity's internal control~~ **or on management's assertion thereon.**

58. The following is the form of report that a practitioner should use when restrictions that significantly limit the scope of the examination are imposed by the client and cause the practitioner to issue a disclaimer of opinion.

Independent Accountant's Report

[Introductory paragraph]

We were engaged to examine management's assertion, **included in the accompanying [title of management's report],** ~~that [identify management's assertion, for example, that W Company maintained effective internal control over financial reporting as of December 31, 19XX,] included in the accompanying [title of management's report]~~ **based on** in accordance with [identify stated or established criteria].²⁶ **Management is responsible for maintaining effective internal control over financial reporting.**

26. The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.

[Scope paragraph should be omitted]

[Explanatory paragraph]

[Include paragraph to describe scope restrictions]

[Opinion paragraph]

Since management [*describe scope restrictions*] and we were unable to apply other procedures to satisfy ourselves as to ~~management's assertion about~~ the entity's internal control over financial reporting, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on ***the effectiveness of the entity's internal control over financial reporting*** ~~management's assertion.~~

[Signature]

[Date]

Opinion Based in Part on the Report of Another Practitioner

59. When another practitioner has examined management's assertion about the effectiveness of the internal control of one or more subsidiaries, divisions, branches, or components of the entity, the practitioner should consider whether he or she may serve as the principal practitioner and use the work and reports of the other practitioner as a basis, in part, for his or her opinion ~~on management's assertion~~. If the practitioner decides it is appropriate for him or her to serve as the principal practitioner, he or she should then decide whether to make reference in the report to the examination performed by the other practitioner. In these circumstances, the practitioner's considerations are similar to those of the independent auditor who uses the work and reports of other independent auditors when reporting on an entity's financial statements. SAS No. 1, *Codification of Auditing Standards and Procedures*, "Part of Audit Performed by Other Independent Auditors" (AICPA, *Professional Standards*, vol. 1, AU sec. 543), provides guidance on the auditor's considerations when deciding whether he or she may serve as the principal auditor and, if so, whether to make reference to the examination performed by the other practitioner.

60. When the practitioner decides to make reference to the report of the other practitioner as a basis, in part, for the practitioner's opinion ~~on management's assertion~~, the practitioner should disclose this fact when describing the scope of the examination and should refer to the report of the other practitioner when expressing

the opinion.²⁷ The following form of the report is appropriate in these circumstances.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, ***included in the accompanying [title of management's report]***, that ~~[identify management's assertion, for example, that~~ W Company maintained effective internal control over financial reporting as of December 31, 19XX] ~~included in the accompanying [title of management report]~~ ***based on [identify established or stated criteria]***.²⁸ ***Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.*** We did not examine management's assertion about the effectiveness of the internal control over financial reporting of B Company, a wholly owned subsidiary, whose financial statements reflect total assets and revenues constituting 20 and 30 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 19XX. Management's assertion about the effectiveness of B Company's internal control over financial reporting was examined by other accountants whose report has been furnished to us, and our opinion, insofar as it relates to ~~management's assertion about~~ the effectiveness of B Company's internal control over financial reporting, is based solely on the report of the other accountants.

[Scope paragraph]

Our examination was ~~made~~ ***conducted*** in accordance with ***attestation*** standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and ***performing*** such other procedures as we considered necessary in the circumstances. We believe that our examination and

27. *Whether the other practitioner's opinion is expressed on management's assertion or on the effectiveness of internal control does not affect the determination of whether the principal practitioner's opinion is expressed on the assertion or on the subject matter itself.*

28. *The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.*

the report of the other accountants provide a reasonable basis for our opinion.

[Standard inherent limitations paragraph]

[Opinion paragraph]

In our opinion, based on our examination and the report of the other accountants, ~~management's assertion [identify management's assertion, for example, that~~ W Company maintained, **in all material respects**, effective internal control over financial reporting as of December 31, 19XX, ~~is fairly stated, in all material respects, based upon [identify established or stated criteria].~~

[Signature]

[Date]

Subsequent Events

61. Changes in internal control or other factors that might significantly affect internal control may occur subsequent to the date **as of which the internal control over financial reporting is being examined** ~~of management's assertion~~ but before the date of the practitioner's report. As described in paragraph 41, the practitioner should obtain management's representations relating to such matters. Additionally, to obtain information about whether changes have occurred that might affect ~~management's assertion about~~ the effectiveness of the entity's internal control and, therefore, the practitioner's report, he or she should inquire about and examine, for this subsequent period, the following:

- a. Relevant internal auditor reports issued during the subsequent period
- b. Independent auditor reports (if other than the practitioner's) of reportable conditions or material weaknesses
- c. Regulatory agency reports on the entity's internal control
- d. Information about the effectiveness of the entity's internal control obtained through other professional engagements

62. If the practitioner obtains knowledge about subsequent events that he or she believes significantly affect ~~management's assertion about~~ the effectiveness of the entity's internal control as of the date of management's assertion, the practitioner should **report directly on the effectiveness of the entity's internal control, and issue a qualified or an adverse opinion** ~~ascertain that management~~

~~has adequately described in its assertion these events and their effect on internal control. If management has not included such a description and appropriately modified its assertion, the practitioner should add to his or her report an explanatory paragraph that includes such a description. If the practitioner is unable to determine the effect of the subsequent event on the effectiveness of the entity's internal control, the practitioner should disclaim an opinion.~~

63. *The practitioner may obtain knowledge about subsequent events with respect to conditions that did not exist at the date of management's assertion but arose subsequent to that date. Occasionally, a subsequent event of this type has such a material impact on the entity that the practitioner may wish to include in his or her report an explanatory paragraph describing the event and its effects or directing the reader's attention to the event and its effects.*

64. The practitioner has no responsibility to keep informed of events subsequent to the date of his or her report; however, the practitioner may later become aware of conditions that existed at that date that might have affected the practitioner's opinion had he or she been aware of them. The practitioner's consideration of such subsequent information is similar to an auditor's consideration of information discovered subsequent to the date of the report on an audit of financial statements described in SAS No. 1, *Codification of Auditing Standards and Procedures*, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" (AICPA, *Professional Standards*, vol. 1, AU sec. 561). The guidance in that Statement requires the auditor to determine whether the information is reliable and whether the facts existed at the date of his or her report. If so, the auditor considers (a) whether the facts would have changed the report if he or she had been aware of them and (b) whether there are persons currently relying on or likely to rely on ***the practitioner's report on management's assertion about the effectiveness of the entity's internal control.*** Based on these considerations, detailed guidance is provided for the auditor in AU section 561.06.

Reporting on Management's Assertion About the Effectiveness of a Segment of the Entity's Internal Control

65. When engaged to ~~examine report on~~ management's assertion ~~about on~~ the effectiveness of only a segment of an entity's internal

control (for example, internal control over financial reporting of an entity's operating division or its accounts receivable), a practitioner should follow the guidance in this Statement and issue a report using the guidance in paragraphs 43 through 58, modified to refer to the segment of the entity's internal control examined. In this situation, the practitioner may use a report such as the following.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, ***included in the accompanying [title of management report],*** ~~[identify management's assertion, for example, that W Company's retail division maintained effective internal control over financial reporting as of December 31, 19XX],~~ ***included in the accompanying [title of management report] based on [identify stated or established criteria].***²⁹ ***Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.***

[Standard scope and inherent limitations paragraphs]

[Opinion paragraph]

In our opinion, ~~management's assertion [identify management's assertion, for example, that W Company's retail division maintained,~~ ***in all material respects,*** effective internal control over financial reporting as of December 31, 19XX] ~~is fairly stated, in all material respects, based upon [identify established or stated criteria].~~

[Signature]

[Date]

Reporting on Management's Assertion About the Suitability of Design of the Entity's Internal Control

66. Management may ***request the practitioner to examine*** ~~present~~ an assertion about the suitability of the design of the entity's internal control for preventing or detecting material misstatements on

²⁹ *The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.*

a timely basis ~~and request the practitioner to examine and report on the assertion~~. For example, prior to granting a new casino a license to operate, a regulatory agency may request a report on whether the internal control that management plans to implement will provide reasonable assurance that the control objectives specified in the regulatory agency's regulations will be achieved. When evaluating the suitability of design of the entity's internal control for the regulatory agency's purpose, the practitioner should obtain an understanding of the components of internal control³⁰ that management should implement to meet the control objectives of the regulatory agency and identify the controls that are relevant to those control objectives.

67. The following is a suggested form of report a practitioner may issue. The actual form of the report should be modified, as appropriate, to fit the particular circumstances.³¹

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion ~~[identify management's assertion, for example, included in the accompanying [title of management report]]~~, that W Company's internal control over financial reporting is suitably designed to prevent or detect material misstatements in the financial statements on a timely basis as of December 31, 19XX, ~~[included in the accompanying [title of management report]]~~ **based on [identify stated or established criteria].³² Management is responsible for the suitable design of internal control over financial reporting. Our responsibility is to express an opinion on the design of internal control based on our examination.**

[Scope paragraph]

Our examination was ~~made~~ **conducted** in accordance with **attestation** standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an under-

30. See paragraph 21.

31. This report assumes that the control criteria of the regulatory agency have been subjected to due process and, therefore, are considered reasonable criteria for reporting purposes. Therefore, there is no limitation on the distribution of this report.

32. *The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.*

standing of the internal control over financial reporting, evaluating the design of the internal control, and **performing** such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[Standard inherent limitations paragraph]

[Opinion paragraph]

In our opinion, ~~management's assertion [identify management's assertion, for example, that~~ W Company's internal control over financial reporting is suitably designed, **in all material respects**, to prevent or detect material misstatements in the financial statements on a timely basis as of December 31, 19XX, ~~is fairly stated, in all material respects, based upon [identify established or stated criteria].~~

[Signature]

[Date]

When **reporting on the suitability of design of the** ~~management presents such an assertion about an~~ entity's internal control that has already been placed in operation, the practitioner should modify his or her report by adding the following to the scope paragraph of the report.

We were not engaged to examine and report on the operating effectiveness of W Company's internal control over financial reporting as of December 31, 19XX, and, accordingly, we express no opinion on operating effectiveness.

Management's Assertion Based on Criteria Specified by a Regulatory Agency

68. A governmental or other agency that exercises regulatory, supervisory, or other public administrative functions may establish its own criteria and require reports on the internal control of entities subject to its jurisdiction. Criteria established by a regulatory agency may be set forth in audit guides, questionnaires, or other publications. The criteria may encompass specified aspects of an entity's internal control and specified aspects of administrative control or compliance with grants, regulations, or statutes. If such criteria have been subjected to due process procedures, including the broad distribution of proposed criteria for public comment, a practitioner should use the form of report illustrated in paragraph 44 ~~or 40, depending on the manner in which management presents its assertion.~~ If, however, such criteria have not been subjected to due process procedures, the practitioner should modify the report by adding a

separate paragraph that limits the distribution of the report to the regulatory agency and to those within the entity.

69. For purposes of these reports, a material weakness is—

- a. A condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that misstatements due to error or fraud in amounts that would be material in relation to the applicable grant or program might occur and not be detected on a timely basis by employees in the normal course of performing their assigned functions.
- b. A condition in which the lack of conformity with the regulatory agency's criteria is material in accordance with any guidelines for determining materiality that are included in such criteria.

70. The following report illustrates one that a practitioner might use when he or she has examined management's assertion ~~on about~~ the effectiveness of the entity's internal control based ~~upon~~ criteria established by a regulatory agency that did not follow due process.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion ~~included in its representation letter dated February 15, 10XX. [Identify management's assertion, for example, included in the accompanying [title of management report]]~~ that W Company's internal control over financial reporting as of December 31, 19XX, is adequate to meet the criteria established by _____ agency, as set forth in its audit guide dated _____.³³

Management is responsible for maintaining internal control over financial reporting. Our responsibility is to express an opinion on whether the internal control is adequate to meet such criteria based on our examination.

[Standard scope and inherent limitations paragraphs]

[Opinion paragraph]

33. The practitioner should identify the management report examined by referring to the title used by management in its report. Further, he or she should use the same description of the entity's internal control as management uses in its report, including the kinds of controls (that is, controls over the preparation of annual financial statements, interim financial statements, or both) on which management is reporting. If the presentation of management's assertion does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.

We understand that the agency considers the controls over financial reporting that meet the criteria referred to in the first paragraph of this report adequate for its purpose. In our opinion, based on this understanding and on our examination, ~~management's assertion~~ ~~[identify management's assertion, for example, that W Company's internal control over financial reporting is adequate,~~ **in all material respects,** to meet the criteria established by _____ agency] ~~is fairly stated, in all material respects, based upon such criteria.~~

[Limitation on distribution paragraph]

This report is intended for the information and use of the board of directors and management of W Company and [agency] and should not be used for any other purpose.³⁴

[Signature]

[Date]

71. When the practitioner issues this form of report, he or she does not assume any responsibility for the comprehensiveness of the criteria established by the regulatory agency. However, the practitioner should report any condition that comes to his or her attention during the course of the examination that he or she believes is a material weakness, even though it may not be covered by the criteria.

72. If a regulatory agency requires ~~the management to~~ **reporting of** all conditions (whether material or not) that are not in conformity with the agency's criteria, the practitioner should ~~determine whether~~ **describe** all conditions of which he or she is aware ~~have been reported by management. If the practitioner concludes that management has not reported all such conditions, he or she should describe them in the report.~~

Other Information in a Client-Prepared Document Containing *the Practitioner's Report on Management's Assertion About the Effectiveness of the Entity's Internal Control*

73. An entity may publish various documents that contain other information in addition to ~~management's assertion~~ **the practitioner's report** on the effectiveness of the entity's internal control ~~and the~~

34. If the report is a matter of public record, the following sentence should be added: "However, this report is a matter of public record and its distribution is not limited."

~~practitioner's report thereon.~~ The practitioner may have performed procedures and issued a report covering some or all of this other information (for example, an audit report on the entity's financial statements), or another practitioner may have done so. Otherwise, the practitioner's responsibility with respect to other information in such a document does not extend beyond the **information management report** identified in his or her report, and the practitioner has no obligation to perform any procedures to corroborate any other information contained in the document. However, the practitioner should read the other information not covered by the practitioner's report or by the report of the other practitioner and consider whether it, or the manner of its presentation, is materially inconsistent with the information appearing in ~~management's~~ **the practitioner's** report, or whether such information contains a material misstatement of fact.

74. If the practitioner believes that the other information is inconsistent with the information appearing in ~~the practitioner's management's report,~~ **the practitioner's** report, he or she should consider whether ~~management's report,~~ **the practitioner's report,** or ~~both~~ requires revision. If the practitioner concludes that ~~the report does these do~~ **the report does** not require revision, he or she should request management to revise the other information. If the other information is not revised to eliminate the material inconsistency, the practitioner should consider other actions, such as revising his or her report to include an explanatory paragraph describing the material inconsistency, withholding the use of his or her report in the document, or withdrawing from the engagement.

75. If the practitioner discovers in the other information a statement that he or she believes is a material misstatement of fact, he or she should discuss the matter with management. In connection with this discussion, the practitioner should consider whether he or she possesses the expertise to assess the validity of the statement, whether standards exist by which to assess the manner of presentation of the information, and whether there may not be valid differences of judgment or opinion. If the practitioner concludes that a material misstatement exists, the practitioner should propose that management consult with some other party whose advice might be useful, such as the entity's legal counsel.

76. If, after discussing the matter, the practitioner concludes that a material misstatement of fact remains, the action taken will depend on his or her judgment in the circumstances. The practitioner should

consider steps such as notifying the entity's management and audit committee in writing of his or her views concerning the information and consulting his or her legal counsel about further action appropriate in the circumstances.

Relationship of the Practitioner's Examination of an Entity's Internal Control to the Opinion Obtained in an Audit

77. The purpose of a practitioner's examination of management's assertion about the effectiveness of an entity's internal control is to express an opinion about whether ~~management's assertion that the entity maintained, is fairly stated in all material respects,~~ **in all material respects**, effective internal control as of a point in time ~~is fairly stated in all material respects,~~ based on the control criteria. In contrast, the purpose of an auditor's consideration of internal control in an audit of financial statements conducted in accordance with generally accepted auditing standards is to enable the auditor to plan the audit and determine the nature, timing, and extent of tests to be performed. Ultimately, the results of the auditor's tests will form the basis for the auditor's opinion on the fairness of the entity's financial statements in conformity with generally accepted accounting principles. The auditor's responsibility in considering the entity's internal control is discussed in SAS No. 55, as amended by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 319).

78. In a financial statement audit, the auditor obtains an understanding of internal control by performing procedures such as inquiries, observations, and inspection of documents. After he or she has obtained this understanding, the auditor assesses the control risk for assertions related to significant account balances and transaction classes. The auditor assesses control risk for an assertion at maximum if he or she believes that controls are unlikely to pertain to the assertion, that controls are unlikely to be effective, or that an evaluation of their effectiveness would be inefficient. When the auditor assesses control risk for an assertion at below maximum, he or she identifies the controls that are likely to prevent or detect material misstatements in that assertion and performs tests of controls to evaluate the effectiveness of such controls.

79. An auditor's consideration of internal control in a financial statement audit is more limited than that of a practitioner engaged to examine management's assertion about the effectiveness of the entity's internal control. However, knowledge the practitioner obtains about the entity's internal control as part of the examination of management's assertion may serve as the basis for his or her understanding of internal control in an audit of the entity's financial statements. Similarly, the practitioner may consider the results of tests of controls performed in connection with an examination of management's assertion, as well as any material weaknesses identified, when assessing control risk in the audit of the entity's financial statements.

80. While an examination of management's assertions about the effectiveness of the entity's internal control and an audit of the entity's financial statements may be performed by the same practitioner, each can be performed by a different practitioner. If the audit of the entity's financial statements is performed by another practitioner, the practitioner may wish to consider any material weaknesses and reportable conditions identified by the auditor and any disagreements between management and the auditor concerning such matters.

Relationship to the Foreign Corrupt Practices Act

81. The Foreign Corrupt Practices Act of 1977 (FCPA) includes provisions regarding internal accounting control for entities subject to the Securities Exchange Act of 1934. Whether an entity is in compliance with those provisions of the FCPA is a legal determination. A practitioner's examination report issued under this Statement does not indicate whether an entity is in compliance with those provisions.

Effective Date

82. This Statement is effective for an examination of management's assertion on the effectiveness of an entity's internal control over financial reporting when the assertion is as of December 15, 1993, or thereafter. Earlier application of this Statement is encouraged. ***The amendments to this Statement are effective for reports on the effectiveness of an entity's internal control over financial reporting issued on or after June 30, 1999; earlier application is encouraged.***

Appendix

83. The following documents contain guidance for practitioners engaged to provide other services in connection with an entity's internal control.

- SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), provides guidance on identifying and communicating reportable conditions that come to the auditor's attention during an audit of financial statements.
- SAS No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA, *Professional Standards*, vol. 1, AU sec. 324), provides guidance to auditors of a service organization on issuing a report on certain aspects of the service organization's internal control that can be used by other auditors, as well as guidance on how other auditors should use such reports.
- Audit and Accounting Guide *Audits of State and Local Governmental Units* provides auditors of state and local governmental entities with a basic understanding of the work they should do and the reports they should issue for audits under *Government Auditing Standards* (1994 Revision), issued by the Comptroller General of the United States.
- **SOP 98-3, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards* 92-9, ~~Audits of Not for Profit Organizations Receiving Federal Awards~~**, provides auditors with a basic understanding of the work they should do and the reports they should issue for audits under *Government Auditing Standards* (1994 Revision), issued by the Comptroller General of the United States.

Amendment to Statement on Standards for Attestation Engagements No. 3, Compliance Attestation

(Amends Statement on Standards for Attestation Engagements No. 3, AICPA, Professional Standards, vol. 1, AT sec. 500)

CHAPTER 1

Introduction and Applicability

1. This Statement provides guidance for engagements related to management's written assertion about either (a) an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants or (b) the effectiveness of an entity's internal control over compliance with specified requirements.¹ Management's assertions may relate to compliance requirements that are either financial or nonfinancial in nature. An attestation engagement conducted in accordance with this Statement should comply with the general, fieldwork, and reporting standards in Statement on Standards for Attestation Engagements (SSAE) No. 1, *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100), and the specific standards set forth in this Statement.

2. This Statement does not—

- a. Affect the auditor's responsibility in an audit of financial statements performed in accordance with generally accepted auditing standards (GAAS).
- b. Apply to situations in which an auditor reports on specified compliance requirements based solely on an audit of financial statements, as addressed in SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623.19-21).
- c. Apply to engagements for which the objective is to report in accordance with SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1, AU

1. Throughout this Statement (a) an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants is referred to as compliance with specified requirements, and (b) an entity's internal control over compliance with specified requirements is referred to as its internal control over compliance. The internal control addressed in this Statement may include parts of, but is not the same as, internal control over financial reporting.

sec. 801), unless the terms of the engagement specify an attestation report under this Statement.

- d. Apply to engagements covered by SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties* (AICPA, *Professional Standards*, vol. 1, AU sec. 634).
- e. Apply to the report that encompasses the internal control over compliance for a broker or dealer in securities as required by rule 17a-5 of the Securities Exchange Act of 1934.²

3. A report issued in accordance with the provisions of this Statement does not provide a legal determination of an entity's compliance with specified requirements. However, such a report may be useful to legal counsel or others in making such determinations.

Scope of Services

4. The practitioner may be engaged to perform agreed-upon procedures to assist users in evaluating management's written assertion about—

- a. The entity's compliance with specified requirements
- b. The effectiveness of the entity's internal control over compliance³
- c. Both

The practitioner also may be engaged to examine management's written assertion about the entity's compliance with specified requirements.

5. An important consideration in determining the type of engagement to be performed is expectations by users of the practitioner's report. Since the users decide the procedures to be performed in an agreed-upon procedures engagement, it often will be in the best interests of the practitioner and users (including the client) to have

2. An example of this report is contained in the AICPA Audit and Accounting Guide *Brokers and Dealers in Securities*.

3. An entity's internal control over compliance is the process by which management obtains reasonable assurance of compliance with specified requirements. Although the comprehensive internal control may include a wide variety of objectives and related policies and procedures, only some of these may be relevant to an entity's compliance with specified requirements [see footnote 1, item b]. The components of the internal control over compliance vary based on the nature of the compliance requirements. For example, an internal control over compliance with a capital requirement would generally include accounting procedures, whereas internal control over compliance with a requirement to practice nondiscriminatory hiring may not include accounting procedures.

an agreed-upon procedures engagement rather than an examination engagement. When deciding whether to accept an examination engagement, the practitioner should consider the risks discussed in paragraphs 28 through 32.

6. A practitioner may be engaged to examine management's assertion about the effectiveness of the entity's internal control over compliance. However, in accordance with SSAE No. 1, the practitioner cannot accept an engagement unless management uses reasonable criteria that have been established by a recognized body or are stated in **or attached to the practitioner's report presentation of the assertion.**⁴ If a practitioner determines that such criteria do exist for internal control over compliance, he or she should perform the engagement in accordance with SSAE No. 1. Additionally, SSAE No. 2, *Reporting on an Entity's Internal Control Over Financial Reporting* (AICPA, *Professional Standards*, vol. 1, AT sec. 400), may be helpful to a practitioner in such an engagement.

7. A practitioner should not accept an engagement to perform a review, as defined in SSAE No. 1, paragraph 44, of management's assertion about an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance.

8. The guidance in this Statement does not apply unless management ~~presents~~ **provides the practitioner with** a written assertion. **The written assertion may be provided to the practitioner in a representation letter or may be presented in a separate report that will accompany the practitioner's report. When management's assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of management's assertion. The practitioner may be engaged to provide other types of** ~~In the absence of a written assertion, man-~~

4. Criteria issued by regulatory agencies and other bodies composed of experts that follow due-process procedures, including procedures for broad distribution of proposed criteria for public comment, normally should be considered reasonable criteria for this purpose. For example, the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's Report, *Internal Control—Integrated Framework*, provides a general framework for effective internal control. However, more detailed criteria relative to specific compliance requirements may have to be developed and an appropriate threshold for measuring the severity of control deficiencies needs to be developed in order to apply the concepts of the COSO report to internal control over compliance. Criteria established by a regulatory agency that does not follow such due process procedures also may be considered reasonable criteria for use by the regulatory agency. However, the practitioner's report generally would have to include a limitation of its use to those within the entity and the regulatory agency. (See SSAE No. 1, *Attestation Standards*, paragraphs 17 through 19, 68 and 69.)

~~agement may engage the practitioner to provide certain nonattest services in connection with the entity's compliance with specified requirements or the entity's internal control over compliance. For example, management may engage the practitioner to provide recommendations on how to improve the entity's compliance or related internal control. A practitioner engaged to provide such nonattest services should refer to the guidance in the Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*, vol. 2, CS sec. 100).~~

Conditions for Engagement Performance

9. A practitioner may perform an engagement related to ~~management's written assertion about~~ an entity's compliance with specified requirements or ~~about~~ the effectiveness of internal control over compliance if ~~both of~~ the following conditions, along with the applicable conditions in paragraph 10, are met.

- a. Management accepts responsibility for the entity's compliance with specified requirements and the effectiveness of the entity's internal control over compliance.
- b. Management evaluates the entity's compliance with specified requirements or the effectiveness of the entity's internal control over compliance.
- c. ***Management provides to the practitioner its written assertion about the entity's compliance with specified requirements or about the effectiveness of the entity's internal control over compliance.***⁵

See also SSAE No. 4, *Agreed-Upon Procedures Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec. 600).

10. A practitioner may perform an examination if, in addition to the conditions listed in paragraph 9, the following conditions are met:

- ~~a. Management makes an assertion about the entity's compliance with specified requirements. If the practitioner's report is intended for~~

5. *Management's written assertion may be in the form of a representation letter provided to the practitioner, an assertion addressed to a third party, or a prescribed schedule or declaration submitted to a third party.*

~~general use, the assertion should be in a representation letter to the practitioner and in a separate report that will accompany the practitioner's report.⁵ If use of the practitioner's report will be restricted to those within the entity and a specified regulatory agency, the assertion might be only in a representation letter.~~

- a.b.** Management's assertion is capable of evaluation against reasonable criteria that either have been established by a recognized body or are stated in ~~the assertion~~ **or attached to the practitioner's report** in a sufficiently clear and comprehensive manner for a knowledgeable reader to understand them, and the assertion is capable of reasonably consistent estimation or measurement using such criteria.⁶
- b.e.** Sufficient evidential matter exists or could be developed to support management's evaluation.

11. In an examination engagement, management's written assertion may take various forms but should be specific enough that users having competence in and using the same or similar measurement and disclosure criteria ordinarily would be able to arrive at materially similar conclusions. For example, an acceptable assertion about compliance with specified requirements might state, "Z Company complied with restrictive covenants contained in paragraphs 13, 14, 15, and 16 *a-d* of its Loan Agreement with Y Bank, dated January 1, 19X1, as of and for the three months ended June 30, 19X2." However, the practitioner should not examine an assertion that is too broad or subjective (for example, "X Company complied with laws and regulations applicable to its activities" or "X Company sufficiently complied") to be capable of reasonably consistent estimation or measurement.

Responsibilities of Management

12. Management is responsible for ensuring that the entity complies with the requirements applicable to its activities. That responsibility encompasses (a) identifying applicable compliance requirements, (b) establishing and maintaining internal control to provide reasonable

⁵ Management's report may be in the form of an assertion addressed to a third party or in the form of a prescribed schedule or declaration submitted to a third party.

⁶ See footnote 4.

assurance that the entity complies with those requirements, (c) evaluating and monitoring the entity's compliance, and (d) specifying reports that satisfy legal, regulatory, or contractual requirements. Management's evaluation may include documentation such as accounting or statistical data, entity policy manuals, accounting manuals, narrative memoranda, procedural write-ups, flowcharts, completed questionnaires, or internal auditors' reports. The form and extent of documentation will vary depending on the nature of the compliance requirements and the size and complexity of the entity. Management may engage the practitioner to gather information to assist it in evaluating the entity's compliance. Regardless of the procedures performed by the practitioner, management must accept responsibility for its assertion and must not base such assertion solely on the practitioner's procedures.

Agreed-Upon Procedures Engagement

13. The objective of the practitioner's agreed-upon procedures is to present specific findings to assist users in evaluating management's assertion about an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance based on procedures agreed upon by the users of the report. A practitioner engaged to perform agreed-upon procedures on management's assertion about an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance should follow the guidance set forth herein and in SSAE No. 4.

14. The practitioner's procedures generally may be as limited or as extensive as the specified users desire, as long as the specified users (a) agree upon the procedures performed or to be performed and (b) take responsibility for the sufficiency of the agreed-upon procedures for their purposes.

15. To satisfy the requirements that the practitioner and the specified users agree upon the procedures performed or to be performed and that the specified users take responsibility for the sufficiency of the agreed-upon procedures for their purposes, ordinarily the practitioner should communicate directly with and obtain affirmative acknowledgment from each of the specified users. For example, this may be accomplished by meeting with the specified users or by distributing a draft of the anticipated report or a copy of the engagement

letter to the specified users and obtaining their agreement. If the practitioner is not able to communicate directly with all of the specified users, the practitioner may satisfy these requirements by applying any one or more of the following or similar procedures.

- Compare the procedures to be applied to written requirements of the specified users.
- Discuss the procedures to be applied with appropriate representatives of the specified users involved.
- Review relevant contracts with or correspondence from the specified parties.

The practitioner should not report on an engagement when specified users do not agree upon the procedures performed or to be performed and do not take responsibility for the sufficiency of the procedures for their purposes. (See SSAE No. 4, paragraph 38, for guidance on satisfying these requirements when the practitioner is requested to add parties as specified users after the date of completion of the agreed-upon procedures.)

16. In an engagement to apply agreed-upon procedures to management's assertion about an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance, the practitioner is required to perform only the procedures that have been agreed to by users.⁷ However, prior to performing such procedures, the practitioner should obtain an understanding of the specified compliance requirements, as discussed in paragraph 17.

17. To obtain an understanding of the requirements specified in management's assertion about compliance, a practitioner should consider the following:

- a. Laws, regulations, rules, contracts, and grants that pertain to the specified compliance requirements, including published requirements
- b. Knowledge about the specified compliance requirements obtained through prior engagements and regulatory reports
- c. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals within the entity

7. SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 322), does not apply to agreed-upon procedures engagements.

(for example, the chief financial officer, internal auditors, legal counsel, compliance officer, or grant or contract administrators)

- d. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals outside the entity (for example, a regulator or a third party specialist)

18. When circumstances impose restrictions on the scope of an agreed-upon procedures engagement, the practitioner should attempt to obtain agreement from the users for modification of the agreed-upon procedures. When such agreement cannot be obtained (for example, when the agreed-upon procedures are published by a regulatory agency that will not modify the procedures), the practitioner should describe such restrictions in his or her report or withdraw from the engagement.

19. The practitioner has no obligation to perform procedures beyond the agreed-upon procedures. However, if noncompliance related to management's assertion comes to the practitioner's attention by other means, such information ordinarily should be included in his or her report.

20. The practitioner may become aware of noncompliance related to management's assertion that occurs subsequent to the period addressed by management's assertion but before the date of the practitioner's report. The practitioner should consider including information regarding such noncompliance in his or her report. However, the practitioner has no responsibility to perform procedures to detect such noncompliance other than obtaining management's representation about noncompliance in the subsequent period, as described in paragraph 67.

21. The practitioner's report on agreed-upon procedures related to management's assertion about an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance should be in the form of procedures and findings. The practitioner should not provide negative assurance about **compliance** or whether management's assertion is fairly stated. The practitioner's report should contain the following elements:

- a. A title that includes the word *independent*
 - b. Identification of the specified users
 - c. A reference to **or statement of** management's assertion about the entity's compliance with specified requirements, or about the
-

effectiveness of an entity's internal control over compliance, including the period or point in time addressed in management's assertion,⁸ and the character of the engagement

- d. A statement that the procedures, which were agreed to by the specified users identified in the report, were performed to assist the users in evaluating ~~management's assertion about~~ the entity's compliance with specified requirements or ~~about~~ the effectiveness of its internal control over compliance, **or management's assertion thereon**
- e. Reference to **attestation** standards established by the American Institute of Certified Public Accountants
- f. A statement that the sufficiency of the procedures is solely the responsibility of the specified users and a disclaimer of responsibility for the sufficiency of those procedures
- g. A list of the procedures performed (or reference thereto) and related findings. The practitioner should not provide negative assurance. See SSAE No. 4, paragraph 26.
- h. Where applicable, a description of any agreed-upon materiality limits. See SSAE No. 4, paragraph 27.
- i. A statement that the practitioner was not engaged to, and did not, perform an examination of management's assertion about compliance with specified requirements or about the effectiveness of an entity's internal control over compliance, a disclaimer of opinion **thereon on the assertion**, and a statement that if the practitioner had performed additional procedures, other matters might have come to his or her attention that would have been reported
- j. A statement of restrictions on the use of the report because it is intended to be used solely by the specified users (However, if the report is a matter of public record, the practitioner should include the following sentence: "However, this report is matter of public record and its distribution is not limited.")
- k. Where applicable, reservations or restrictions concerning procedures or findings as discussed in SSAE No. 4, paragraphs 35, 37, 41, and 42
- l. Where applicable, a description of the nature of the assistance provided by the specialist as discussed in SSAE No. 4, paragraphs 21-23

8. Generally, management's assertion about compliance with specified requirements will address a *period* of time, whereas an assertion about internal control over compliance will address a *point* in time.

22. The following is an illustration of an agreed-upon procedures report on management's assertion about an entity's compliance with specified requirements in which procedures and findings are enumerated rather than referenced.

Independent Accountant's Report on Applying Agreed-Upon Procedures

We have performed the procedures enumerated below, which were agreed to by *[list specified users of report]*, solely to assist the users in evaluating management's assertion about *[name of entity]*'s compliance with *[list specified requirements]* during the *[period]* ended *[date]*, included in the accompanying *[title of management report]*.^{9 10} This agreed-upon procedures engagement was performed in accordance with **attestation** standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

[Include paragraphs to enumerate procedures and findings]

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on management's assertion. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of *[list or refer to specified users]* and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

[Signature]

[Date]

9. If management's assertion is in a representation letter rather than a separate, attached report, the first sentence of this paragraph would state: "We have performed the procedures enumerated below, included in its representation letter dated *[date]*." [As amended, effective for reports on agreed-upon procedures engagements dated after April 30, 1996, by Statement on Standards for Attestation Engagements No. 4.] (See section 600.) **If management's assertion is stated in the practitioner's report and does not accompany the practitioner's report, the phrase "included in the accompanying *[title of management report]*" would be omitted.**

10. If the agreed-upon procedures have been published by a third-party user (for example, a regulator in regulatory policies or a lender in a debt agreement), this sentence might begin: "We have performed the procedures included in *[title of publication or other document]* and enumerated below, which were agreed to by *[list users of report]*, solely to assist the users in evaluating management's assertion about..."

23. Evaluating compliance with certain requirements may require interpretation of the laws, regulations, rules, contracts or grants, that establish those requirements. In such situations, the practitioner should consider whether he or she is provided with the reasonable criteria required to evaluate an assertion under the third general attestation standard. If these interpretations are significant, the practitioner may include a paragraph stating the description and the source of interpretations made by the entity's management. An example of such a paragraph, which should precede the procedures and findings paragraph(s), follows:

We have been informed that, under [*name of entity*]'s interpretation of [*identify the compliance requirement*], [*explain the nature and source of the relevant interpretation*].

24. The following is an illustration of an agreed-upon procedures report on management's assertion about the effectiveness of an entity's internal control over compliance in which the procedures and findings are enumerated rather than referenced.

Independent Accountant's Report on Applying Agreed-Upon Procedures

We have performed the procedures enumerated below, which were agreed to by [*list specified users*], solely to assist the users in evaluating management's assertion about the effectiveness of [*name of entity*]'s internal control over compliance with [*list specified requirements*] as of [*date*], included in the accompanying [*title of management report*].^{11 12} This agreed-upon procedures engagement was performed in accordance with **attestation** standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

[*Include paragraphs to enumerate procedures and findings*]

11. If management's assertion is stated in the practitioner's report and does not accompany the practitioner's report, the phrase "included in the accompanying [*title of management report*]" would be omitted.

12. If the agreed-upon procedures have been published by a third-party user (for example, a regulator in regulatory policies or a lender in a debt agreement), this sentence might begin: "We have performed the procedures included in [*title of publication or other document*] and enumerated below, which were agreed to by [*list users of report*], solely to assist the users in evaluating management's assertion about..."

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on management's assertion. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of *[list or refer to specified users]* and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

[Signature]

[Date]

25. In some agreed-upon procedures engagements, management's assertion may address both compliance with specified requirements and the effectiveness of internal control over compliance. In these engagements, the practitioner may issue one report that addresses both ~~assertions~~. For example, the first sentence of the introductory paragraph should state—

We have performed the procedures enumerated below, which were agreed to by *[list users of report]*, solely to assist the users in evaluating management's assertions about *[name of entity]*'s compliance with *[list specified requirements]* during the *[period]* ended *[date]* and about the effectiveness of *[name of entity]*'s internal control over compliance with the aforementioned compliance requirements as of *[date]*, included in the accompanying *[title of management report]*.¹³

26. The date of completion of the agreed-upon procedures should be used as the date of the practitioner's report.

Examination Engagement

27. The objective of the practitioner's examination procedures applied to management's assertion about an entity's compliance with specified requirements is to express an opinion **on an entity's compliance or about** whether management's assertion **about such compliance** is fairly stated, in all material respects, based on established or agreed-upon criteria. To express such an opinion, the practitioner accumulates sufficient evidence ~~in support of management's assertion~~

13. If management's assertion is stated in the practitioner's report and does not accompany the practitioner's report, the phrase "included in the accompanying *[title of management report]*" would be omitted.

about the entity's compliance with specified requirements, thereby limiting attestation risk to an appropriately low level.

Attestation Risk

28. In an engagement to examine management's assertion about compliance with specified requirements, the practitioner seeks to obtain reasonable assurance that **the entity complied**, ~~management's assertion is fairly stated~~ in all material respects, based on established or agreed-upon criteria. This includes designing the examination to detect both intentional and unintentional noncompliance that is material to management's assertion. Absolute assurance is not attainable because of factors such as the need for judgment, the use of sampling, and the inherent limitations of internal control over compliance and because much of the evidence available to the practitioner is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between client personnel and third parties or among management or employees of the client. Therefore, the subsequent discovery that material noncompliance exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the practitioner.

29. Attestation risk is the risk that the practitioner may unknowingly fail to modify appropriately his or her opinion ~~on management's assertion~~. It is composed of inherent risk, control risk, and detection risk. For purposes of a compliance examination, these components are defined as follows:

- a. *Inherent risk*—The risk that material noncompliance with specified requirements could occur, assuming there are no related controls
- b. *Control risk*—The risk that material noncompliance that could occur will not be prevented or detected on a timely basis by the entity's controls
- c. *Detection risk*—The risk that the practitioner's procedures will lead him or her to conclude that material noncompliance does not exist when, in fact, such noncompliance does exist

Inherent Risk

30. In assessing inherent risk, the practitioner should consider factors affecting risk similar to those an auditor would consider when planning

an audit of financial statements. Such factors are discussed in SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316.16-19). In addition, the practitioner should consider factors relevant to compliance engagements, such as the following:

- The complexity of the specified compliance requirements
- The length of time the entity has been subject to the specified compliance requirements
- Prior experience with the entity's compliance
- The potential impact of noncompliance

Control Risk

31. The practitioner should assess control risk as discussed in paragraphs 42 and 43. Assessing control risk contributes to the practitioner's evaluation of the risk that material noncompliance exists. The process of assessing control risk (together with assessing inherent risk) provides evidential matter about the risk that such noncompliance may exist. The practitioner uses this evidential matter as part of the reasonable basis for his or her opinion ~~on management's assertion.~~

Detection Risk

32. In determining an acceptable level of detection risk, the practitioner assesses inherent risk and control risk and considers the extent to which he or she seeks to restrict attestation risk. As assessed inherent risk or control risk decreases, the acceptable level of detection risk increases. Accordingly, the practitioner may alter the nature, timing, and extent of compliance tests performed based on the assessments of inherent risk and control risk.

Materiality

33. In an examination of management's assertion about an entity's compliance with specified requirements, the practitioner's consideration of materiality differs from that of an audit of financial statements in accordance with GAAS. In an examination of management's assertion about an entity's compliance with specified requirements, the practitioner's consideration of materiality is affected by (a) the nature of management's assertion and the compliance requirements, which may or may not be quantifiable in monetary terms, (b) the nature and frequency of noncompliance identified with appropriate consideration

of sampling risk, and (c) qualitative considerations, including the needs and expectations of the report's users.

34. In some situations, the terms of the engagement may provide for a supplemental report of all or certain noncompliance discovered. Such terms should not change the practitioner's judgments about materiality in planning and performing the engagement or in forming an opinion on ~~management's assertion about~~ an entity's compliance with specified requirements **or on management's assertion about such compliance.**

Performing an Examination Engagement

35. The practitioner should exercise (a) due care in planning, performing, and evaluating the results of his or her examination procedures and (b) the proper degree of professional skepticism to achieve reasonable assurance that material noncompliance will be detected.

36. In an examination of management's assertion about the entity's compliance with specified requirements, the practitioner should—

- a. Obtain an understanding of the specified compliance requirements (paragraph 37).
- b. Plan the engagement (paragraphs 38 through 41).
- c. Consider relevant portions of the entity's internal control over compliance (paragraphs 42 through 44).
- d. Obtain sufficient evidence including testing compliance with specified requirements (paragraphs 45 through 46).
- e. Consider subsequent events (paragraphs 47 through 49).
- f. Form an opinion about whether ~~management's assertion about~~ the entity's **complied, in all material respects,** ~~compliance with~~ specified requirements **(or whether management's assertion about such compliance** is fairly stated in all material respects), based on the established or agreed-upon criteria ~~(paragraph 50).~~

Obtaining an Understanding of the Specified Compliance Requirements

37. A practitioner should obtain an understanding of the **specified compliance** requirements ~~specified in management's assertion about compliance.~~ To obtain such an understanding, a practitioner should consider the following:

- a. Laws, regulations, rules, contracts, and grants that pertain to the specified compliance requirements, including published requirements
- b. Knowledge about the specified compliance requirements obtained through prior engagements and regulatory reports
- c. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals within the entity (for example, the chief financial officer, internal auditors, legal counsel, compliance officer, or grant or contract administrators)
- d. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals outside the entity (for example, a regulator or third-party specialist)

Planning the Engagement

General Considerations

38. Planning an engagement to examine management's assertion about the entity's compliance with specified requirements involves developing an overall strategy for the expected conduct and scope of the engagement. The practitioner should consider the planning matters discussed in SSAE No. 1, paragraphs 31-36.

Multiple Components

39. In an engagement to examine management's assertion about an entity's compliance with specified requirements when the entity has operations in several components (for example, locations, branches, subsidiaries, or programs), the practitioner may determine that it is not necessary to test compliance with requirements at every component. In making such a determination and in selecting the components to be tested, the practitioner should consider factors such as the following:

- a. The degree to which the specified compliance requirements apply at the component level
 - b. Judgments about materiality
 - c. The degree of centralization of records
 - d. The effectiveness of the control environment, particularly management's direct control over the exercise of authority delegated to others and its ability to supervise activities at various locations effectively
 - e. The nature and extent of operations conducted at the various components
 - f. The similarity of operations over compliance for different components
-

Using the Work of a Specialist

40. In some compliance engagements, the nature of the specified compliance requirements may require specialized skill or knowledge in a particular field other than accounting or auditing. In such cases, the practitioner may use the work of a specialist and should follow the relevant performance and reporting guidance in SAS No. 74, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1, AU sec. 336).

Internal Audit Function

41. Another factor the practitioner should consider when planning the engagement is whether the entity has an internal audit function and the extent to which internal auditors are involved in monitoring compliance with the specified requirements. A practitioner should consider the guidance in SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 322), when addressing the competence and objectivity of internal auditors, the nature, timing and extent of work to be performed, and other related matters.

Consideration of Internal Control Over Compliance

42. The practitioner should obtain an understanding of relevant portions of internal control over compliance sufficient to plan the engagement and to assess control risk for compliance with specified requirements. In planning the examination, such knowledge should be used to identify types of potential noncompliance, to consider factors that affect the risk of material noncompliance, and to design appropriate tests of compliance.

43. A practitioner generally obtains an understanding of the design of specific controls by performing: inquiries of appropriate management, supervisory, and staff personnel; inspection of the entity's documents; and observation of the entity's activities and operations. The nature and extent of procedures a practitioner performs vary from entity to entity and are influenced by factors such as the newness and complexity of the specified requirements, the practitioner's knowledge of internal control over compliance obtained in previous professional engagements, the nature of the specified compliance requirements, an understanding of the industry in which the entity operates, and judgments about materiality. When seeking to assess control risk below

the maximum, the practitioner should perform tests of controls to obtain evidence to support the assessed level of control risk.

44. During the course of an engagement to examine management's assertion, the practitioner may become aware of significant deficiencies in the design or operation of internal control over compliance that could adversely affect the entity's ability to comply with specified requirements. A practitioner's responsibility to communicate these deficiencies in an examination of management's assertion about an entity's compliance with specified requirements is similar to the auditor's responsibility described in SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325).

Obtaining Sufficient Evidence

45. The practitioner should apply procedures to provide reasonable assurance of detecting material noncompliance. Determining these procedures and evaluating the sufficiency of the evidence obtained are matters of professional judgment. When exercising such judgment, practitioners should consider the guidance contained in SSAE No. 1, *Attestation Standards*, paragraphs 40-43, and SAS No. 39, *Audit Sampling*.

46. For engagements involving compliance with regulatory requirements, the practitioner's procedures should include reviewing reports of significant examinations and related communications between regulatory agencies and the entity and, when appropriate, making inquiries of the regulatory agencies, including inquiries about examinations in progress.

Consideration of Subsequent Events

47. The practitioner's consideration of subsequent events in an examination of management's assertion about the entity's compliance with specified requirements is similar to the auditor's consideration of subsequent events in a financial statement audit, as outlined in SAS No. 1, *Codification of Auditing Standards and Procedures*, "Subsequent Events" (AICPA, *Professional Standards*, vol. 1, AU sec. 560). The practitioner should consider information about such events that comes to his or her attention after the end of the period addressed by **the practitioner's report** management's assertion and prior to the issuance of his or her report.

48. Two types of subsequent events require consideration by management and evaluation by the practitioner. The first consists of events that provide additional information about the entity's compliance during the period addressed by ***the practitioner's report*** ~~management's assertion~~ and may affect ~~management's assertion and, therefore,~~ the practitioner's report. For the period from the end of the reporting period (or point in time) to the date of the practitioner's report, the practitioner should perform procedures to identify such events that provide additional information about compliance during the reporting period. Such procedures should include, but may not be limited to, inquiring about and considering the following information:

- Relevant internal auditors' reports issued during the subsequent period
- Other practitioners' reports identifying noncompliance, issued during the subsequent period
- Regulatory agencies' reports on the entity's noncompliance, issued during the subsequent period
- Information about the entity's noncompliance, obtained through other professional engagements for that entity

49. The second type consists of noncompliance that occurs subsequent to the period ***being reported on*** ~~addressed by management's assertion~~ but before the date of the practitioner's report. The practitioner has no responsibility to detect such noncompliance. However, should the practitioner become aware of such noncompliance, it may be of such a nature and significance that disclosure of it is required to keep management's assertion from being misleading. In such cases, the practitioner should include, in his or her report, an explanatory paragraph describing the nature of the noncompliance ~~if it was not disclosed in management's assertion accompanying the practitioner's report.~~

Forming an Opinion on Management's Assertion

50. In evaluating whether ***the entity has complied, in all material respects, [or whether*** management's assertion ***about such compliance*** is stated fairly in all material respects,] the practitioner should consider (a) the nature and frequency of the noncompliance identified and (b) whether such noncompliance is material relative to the nature of the compliance requirements, as discussed in paragraph 33.

Reporting

~~53. The form of the practitioner's report depends on, among other things, the method in which management presents its written assertion:~~

~~• If management's assertion is presented in a separate report that will accompany the practitioner's report, the practitioner should use the form of report discussed in paragraphs 54 and 55.~~

~~• If management presents its assertion only in a representation letter to the practitioner, the practitioner should use the form of report discussed in paragraphs 56 and 57.~~

51. ~~When management presents its assertion in a separate report that will accompany the practitioner's report,~~ The practitioner's report **on an examination**, which is ordinarily addressed to the entity, should include ***the following***:

- a. A title that includes the word *independent*
- b. ~~A reference to~~ **An identification of** management's assertion about the entity's compliance with specified requirements, including the period covered by management's assertion.¹⁴ **When management's assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of management's assertion.**
- c. A statement that compliance with the requirements addressed in management's assertion is the responsibility of the entity's management ~~and that the practitioner's responsibility is to express an opinion on management's assertion about the entity's compliance with those requirements based on the examination.~~
- d. **A statement that the practitioner's responsibility is to express an opinion on the entity's compliance with those requirements or on management's assertion on such compliance based on his or her examination.**
- e. ~~A statement that the examination was made~~ **conducted** in accordance with **attestation** standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the entity's compliance

14. A practitioner also may be engaged to report on management's assertion about an entity's compliance with specified requirements as of a point in time. In this case, the illustrative reports in this Statement should be adapted as appropriate.

with those requirements and performing such other procedures as the practitioner considered necessary in the circumstances. ~~In addition, the report should include a statement that the practitioner believes the examination provides a reasonable basis for his or her opinion and a statement that the examination does not provide a legal determination on the entity's compliance.~~

- f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion.**
- g. A statement that the examination does not provide a legal determination on the entity's compliance.**
- h.e. The practitioner's opinion on whether *the entity complied, in all material respects, with specified requirements* [or whether management's assertion about compliance with specified requirements is fairly stated, in all material respects,] based on established or agreed-upon criteria.^{15 16} (*See paragraph 58 for reporting on material noncompliance.*)**
- i. When the assertion has been prepared in conformity with criteria specified by a regulatory agency or that have been agreed upon by the asserter and the specified parties, the practitioner's report should contain—**
 - A statement of limitations on the use of the report because it is intended solely for specified parties (see the fourth reporting standard).¹⁷**
 - A statement, when established criteria exist, that the assertion is not intended to be that which would have been presented if the assertion were presented based on [identify established criteria].**
- j. The manual or printed signature of the practitioner's firm.**
- k. The date of the examination report.**

15. Frequently, criteria will be contained in the compliance requirements, in which case it is not necessary to repeat the criteria in the practitioner's report; however, if the criteria are not included in the compliance requirement, the practitioner's report should identify the criteria. For example, if a compliance requirement is to "maintain \$25,000 in capital," it would not be necessary to identify the \$25,000 in the report; however, if the requirement is to "maintain adequate capital," the practitioner should identify the criteria used to define "adequate."

16. Although the practitioner's report generally will be for general use ~~when management presents its assertion in an accompanying report~~, the practitioner is not precluded from restricting the use of the report.

17. *In certain situations, however, criteria that have been specified by management and other report users may be reasonable for general distribution.*

52. ~~56.~~ When management presents its written assertion about an entity's compliance in a representation letter to the practitioner and not in a separate report to accompany the practitioner's report, the practitioner should state management's assertion in the introductory paragraph. The opinion paragraph should report on the entity's compliance with the specified requirements.

53. The following is the form of report a practitioner should use when he or she **is expressing an opinion on** ~~has examined management's assertion about~~ an entity's compliance with specified requirements during a period of time.

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, **included in the accompanying [title of management's report],** ~~about that~~ [name of entity]'s compliance **complied** with [list specified compliance requirements] during the [period] ended [date] ~~included in the accompanying [title of management report].~~^{18 19} Management is responsible for [name of entity]'s compliance with those requirements. Our responsibility is to express an opinion on ~~management's assertion about the Company's~~ **[name of entity]'s** compliance based on our examination.

[Scope paragraph]

Our examination was ~~made~~ **conducted** in accordance with **attestation** standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about [name of entity]'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on [name of entity]'s compliance with specified requirements.

[Opinion paragraph]

In our opinion, ~~management's assertion [identify management's assertion for example, that Z Company~~ [name of entity] complied,

18. The practitioner should identify the management report examined by reference to the report title used by management in its report. Further, he or she should use the same description of compliance requirements as management uses in its report.

19. **If management's assertion is stated in the practitioner's report and does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.**

in all material respects, with the aforementioned requirements for the year ended December 31, 19XX1] ~~is fairly stated, in all material respects.~~²⁰

[Restricted use paragraph]

This report is intended solely for the information and use of [list specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]

[Date]

~~56. When management presents its written assertion about an entity's compliance in a representation letter to the practitioner and not in a separate report to accompany the practitioner's report, the practitioner should modify his or her report to include management's assertion about the entity's compliance and add a paragraph that limits the use of the report to specified parties. For example, a regulatory agency may request a report from the practitioner on management's assertion about the entity's compliance with specified requirements but not request a separate written assertion from management.~~

54. The following is the form of report that a practitioner should use in such circumstances; ***when expressing an opinion on management's assertion about compliance with specified requirements.***

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, ~~included in its representation letter dated [date],~~ ***included in the accompanying [title of management report],*** that [name of entity] complied with [list specified compliance requirements] during the [period] ended [date].^{21 22} As discussed in that representation letter, ~~management~~ Management is responsible for [name of entity]'s compliance with those requirements. Our responsibility is to express an opinion on management's assertion about ~~the Company's~~ ***[name of entity]'s*** compliance based on our examination.

20. If it is necessary to identify criteria (see footnote 15), the criteria should be identified in the opinion paragraph (for example, "...in all material respects, based on the criteria set forth in Attachment 1").

21. ***The practitioner should identify the management report examined by reference to the report title used by management in its report. Further, he or she should use the same description of compliance requirements as management uses in its report.***

22. ***If management's assertion is stated in the practitioner's report and does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.***

[Standard scope ~~and opinion~~ paragraphs]

[Opinion paragraph]

*In our opinion, management's assertion that [name of entity] complied with the aforementioned requirements during the [period] ended [date] is fairly stated, in all material respects.*²³

[Restricted use paragraph]

This report is intended solely for the information and use of [list specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Limitation on use paragraph]

~~This report is intended solely for the information of the audit committee, management, and [specify legislative or regulatory body].~~²³

[Signature]

[Date]

~~58. When the presentation of assertions has been prepared in conformity with specified criteria that have been agreed upon by management and the users, the practitioner's report also should contain a statement of limitations on the use of the report because it is intended solely for specified parties.~~²⁴

55. Evaluating compliance with certain requirements may require interpretation of the laws, regulations, rules, contracts, or grants that establish those requirements. In such situations, the practitioner should consider whether he or she is provided with the reasonable criteria required to evaluate **compliance** ~~an assertion~~ under the third general attestation standard. If these interpretations are significant, the practitioner may include a paragraph stating the description and the source of interpretations made by the entity's management. The following is an example of such a paragraph, which should directly follow the scope paragraph:

We have been informed that, under [name of entity]'s interpretation of [identify the compliance requirement], [explain the source and nature of the relevant interpretation].

23. If it is necessary to identify criteria (see footnote 15), the criteria should be identified in the opinion paragraph (for example, "...in all material respects, based on the criteria set forth in Attachment 1").

23. If the report is part of the public record, the following sentence should be included in the report: "However, this report is a matter of public record and its distribution is not limited."

24. In certain situations, however, criteria that have been specified by management and other report users may be "reasonable" for general distribution. See section 100.70.

56. The date of completion of the examination procedures should be used as the date of the practitioner's report.

Report Modifications

57. The practitioner should modify the standard reports *described* in paragraphs ~~55 and 57~~ 54, if any of the following conditions exist:

- There is material noncompliance with specified requirements (paragraphs 58 through 65).
- There is a matter involving a material uncertainty (paragraph 66).
- There is a restriction on the scope of the engagement.²⁴
- The practitioner decides to refer to the report of another practitioner as the basis, in part, for the practitioner's report.²⁵

Material Noncompliance

58. When an examination of management's assertion about an entity's compliance with specified requirements discloses noncompliance with the applicable requirements that the practitioner believes have a material effect on the entity's compliance, the practitioner should modify the report *and, to most effectively communicate with the reader of the report, should state his or her opinion on the entity's specified compliance requirements, not on management's assertion.* The nature of the report modification depends on whether management discloses, in its assertion, a description of the noncompliance with requirements.

59. If management discloses the noncompliance and appropriately modifies its assertion about the entity's compliance with specified requirements, the practitioner should modify the opinion paragraph by including a reference to the noncompliance and add an explanatory paragraph (~~after~~ *before* the opinion paragraph) that ~~emphasizes~~ *describes* the noncompliance.

60. The following is the form of report, modified with explanatory language, that a practitioner should use when he or she has ~~identified~~

24. The practitioner should refer to section SSAE No. 2, paragraphs 55-58, for guidance on a report modified for a scope restriction and adapt such guidance to the standard reports in this Statement.

25. The practitioner should refer to section SSAE No. 2, paragraphs 59 and 60, for guidance on an opinion based in part on the report of another practitioner and adapt such guidance to the standard reports in this Statement.

~~noncompliance and management has appropriately modified its assertion for the noncompliance~~ ***concluded that a qualified opinion is appropriate under the circumstances.***

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, included in the accompanying [title of management report], that, except for the noncompliance with [list requirements] described in the third paragraph, [name of entity] complied with [list specified compliance requirements] for the [period] ended [date].²⁶ Management is responsible for compliance with those requirements. Our responsibility is to express an opinion on [name of entity]'s compliance based on our examination.

~~[Standard scope and opinion paragraphs]~~

[Explanatory paragraph]

Our examination disclosed the following material noncompliance with [type of compliance requirement] applicable to [name of entity] during the [period] ended [date]. [Describe noncompliance.]

~~[Opinion paragraph]~~

In our opinion, except for the material noncompliance described in the third paragraph, [name of entity] complied, in all material respects, with the aforementioned requirements for the [period] ended [date].

~~In our opinion, management's assertion [identify management's assertion—for example, that except for noncompliance with [list requirements], Z Company complied with the aforementioned requirements for the year ended December 31, 10X1], described in management's report, is fairly stated, in all material respects.~~

~~[Explanatory paragraph]~~

As discussed in management's assertion, the following material noncompliance occurred at [name of entity] during the [period] ended [date]. [Describe noncompliance.]

26. If management's assertion is stated in the practitioner's report and does not accompany the practitioner's report, the phrase "included in the accompanying [title of management report]" would be omitted.

[Restricted use paragraph]

This report is intended solely for the information and use of [list specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]

[Date]

61. *The following is the form of report, modified with explanatory language, that a practitioner should use when he or she concludes that an adverse opinion is appropriate in the circumstances and management has appropriately modified its assertion for the noncompliance.*

Independent Accountant's Report

[Introductory paragraph]

We have examined management's assertion, included in the accompanying [title of management report], that, because of the effect of the noncompliance described in the third paragraph, [name of entity] has not complied with [list specified compliance requirements] for the [period] ended [date]. Management is responsible for compliance with those requirements. Our responsibility is to express an opinion on [name of entity]'s compliance based on our examination.

[Standard scope paragraph]

[Explanatory paragraph]

Our examination disclosed the following material noncompliance with [type of compliance requirement] applicable to [name of entity] during the [period] ended [date]. [Describe noncompliance.]

[Opinion paragraph]

In our opinion, because of the effect of the noncompliance described in the third paragraph, [name of entity] has not complied with the aforementioned requirements for the [period] ended [date].

[Restricted use paragraph]

This report is intended solely for the information and use of [list specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]

[Date]

Disagreements With Management

62. In some circumstances, management may disagree with the practitioner over the existence of material noncompliance and, therefore, not include in its assertion **to the practitioner** a description of such noncompliance. Alternatively, the management may describe noncompliance but ~~not modify its assertion~~ **assert to the practitioner** that the entity complied with specified requirements. In such cases, the practitioner should express either a qualified or **an** adverse opinion **directly on the entity's compliance** ~~on management's assertion~~, depending on the materiality of the noncompliance. In deciding whether to modify the opinion, and whether a modification should be a qualified or **an** adverse opinion, the practitioner should consider such factors as the significance of the noncompliance to the entity and the pervasiveness of the noncompliance.

63. The following is the form of report a practitioner should use when he or she concludes that a qualified opinion is appropriate in the circumstances.

Independent Accountant's Report

[Standard introductory and scope paragraphs]

[Explanatory paragraph]

Our examination disclosed the following material noncompliance with [type of compliance requirement] applicable to [name of entity] during the [period] ended [date]. [Describe noncompliance.]

[Opinion paragraph]

In our opinion, except for the material noncompliance described in the third paragraph, ~~management's assertion [identify management's assertion, for example, that Z Company complied with the aforementioned requirements is fairly stated]~~ [name of entity] complied with the aforementioned requirements for the [period] ~~year ended [date] December 31, 19X1.~~

[Restricted use paragraph]

This report is intended solely for the information and use of [list specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]

[Date]

64. The following is the form of report a practitioner should use when he or she concludes that an adverse opinion is appropriate in the circumstances.

Independent Accountant's Report

[Standard introductory and scope paragraphs]

[Explanatory paragraph]

Our examination disclosed the following material noncompliance with [type of compliance requirement] applicable to [name of entity] during the [period] ended [date]. [Describe noncompliance.]

[Opinion paragraph]

In our opinion, because of the material noncompliance described in the third paragraph, ~~management's assertion [identify management's assertion, for example, that Z Company complied with the aforementioned requirements for the year ended December 31, 19X1] is not fairly stated, [name of entity] has not complied with the aforementioned requirements for the [period] ended [date].~~

[Restricted use paragraph]

This report is intended solely for the information and use of [list specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]

[Date]

65. If the practitioner's ~~issues an examination~~ report on ***his or her examination of*** management's assertion about the entity's compliance with specified requirements ***is included in a the same*** document that ***also*** includes his or her audit report on the entity's financial statements, the following sentence should be included in the paragraph of an examination report that describes material non-compliance:

These conditions were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 19XX financial statements, and this report does not affect our report dated [date of report] on those financial statements.

The practitioner also may include the preceding sentence when the two reports are not included in the same document.

Material Uncertainty

66. In certain instances, the outcome of future events that may ~~effect~~ **have a material effect on** the determination of compliance with specified requirements during a previous period is not susceptible to reasonable estimation by management. When such uncertainties exist, it cannot be determined whether an entity complied with specified requirements ~~and, therefore, whether management's assertion is fairly stated~~. For example, an entity may be involved in litigation or a regulatory investigation that may, at the time of the engagement, cause the determination of compliance to be uncertain. ~~When such a matter exists and is included in management's assertion, the practitioner should add an explanatory paragraph in his or her report describing the uncertainty. When such a matter exists but is not included in management's assertion, the practitioner should add an explanatory paragraph in his or her report and consider the need for a qualified or adverse opinion. Accordingly, when a material uncertainty exists, the practitioner should consider whether sufficient evidence exists to form an unqualified opinion, or whether to express a qualified opinion or to disclaim an opinion. In the case of a qualified opinion or a disclaimer of opinion, the practitioner should report directly on the entity's compliance.~~

Management's Representations

67. In an agreed-upon procedures engagement or an examination engagement, the practitioner should obtain management's written representations²⁷—

- a. Acknowledging management's responsibility for complying with the specified requirements.
- b. Acknowledging management's responsibility for establishing and maintaining effective internal control over compliance.
- c. Stating that management has performed an evaluation of (1) the entity's compliance with specified requirements or (2) the entity's controls for ensuring compliance and detecting noncompliance with requirements, as applicable.

27. ~~Client Representations~~ SAS No. 85, **Management Representations** (AICPA, *Professional Standards*, vol. 1, AU sec. 333.09), provides guidance on the date as of which management should sign such a representation letter and on which member(s) of management should sign it.

- d. Stating management's assertion about the entity's compliance with the specified requirements or about the effectiveness of internal control over compliance, as applicable, based on the stated or established criteria.
- e. Stating that management has disclosed to the practitioner all known noncompliance.
- f. Stating that management has made available all documentation related to compliance with the specified requirements.
- g. Stating management's interpretation of any compliance requirements that have varying interpretations.
- h. Stating that management has disclosed any communications from regulatory agencies, internal auditors, and other practitioners concerning possible noncompliance with the specified requirements, including communications received between the end of the period addressed in management's assertion and the date of the practitioner's report.
- i. Stating that management has disclosed any known noncompliance occurring subsequent to the period for which, or date as of which, management selects to make its assertion.

68. Management's refusal to furnish all appropriate written representations also constitutes a limitation on the scope of the engagement that requires the practitioner to withdraw from an agreed-upon procedures engagement and issue a qualified opinion or disclaimer of opinion in an examination engagement. Further, the practitioner should consider the effects of management's refusal on his or her ability to rely on other management representations.

Other Information in a Client-Prepared Document Containing Management's Assertion About the Entity's Compliance With Specified Requirements or the Effectiveness of the Internal Control Over Compliance

69. An entity may publish various documents that contain information ("other information") in addition to ***the practitioner's report or*** management's assertion (report) on either (a) the entity's compliance with specified requirements or (b) the effectiveness of the entity's internal control over compliance and the practitioner's

report thereon. The practitioner may have performed procedures and issued a report covering the other information. Otherwise, the practitioner's responsibility with respect to other information in such a document does not extend beyond **information included in his or her report or** the management report identified in his or her report, and the practitioner has no obligation to perform any procedures to corroborate other information contained in the document. However, the practitioner should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with the information appearing in **his or her or** management's report or whether such information contains a material misstatement of fact.

70. The practitioner should follow the guidance in SSAE No. 2, paragraphs 73-75, if he or she believes the other information is inconsistent with the information appearing in **the practitioner's or** management's report or if he or she becomes aware of information that he or she believes is a material misstatement of fact.

Effective Date

71. This Statement is effective for engagements in which management's assertion is as of, or for a period ending, June 15, 1994, or thereafter, except as noted in paragraph 72. Earlier application of this Statement is encouraged. ***Amendments to this Statement are effective for reports issued on or after June 30, 1999; earlier application is encouraged.***

72. For engagements to perform agreed-upon procedures to test a financial institution's compliance with specified safety and soundness laws in accordance with the Federal Deposit Insurance Corporation Improvement Act of 1991, this Statement should be implemented when management's assertion is as of, or for a period ending, December 31, 1993, or thereafter.

This Statement entitled Amendments to Statement on Standards for Attestation Engagements Nos. 1, 2 and 3 was adopted unanimously by the assenting votes of the fifteen members of the board.

Auditing Standards Board (1998)

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Note: *Statements on Standards for Attestation Engagements are issued by the Auditing Standards Board, the senior technical body of the Institute designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Conduct requires compliance with these standards.*

